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ECONOMIC ANALYSIS FOR POLICY REFORM IN AFRICA WORKSHOP
EAGER COUNTRY WORKSHOP FIVE: SOUTH AFRICA

FINAL REPORT

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Abbreviations

AERC	African Economic Research Consortium
AGOA	African Growth and Opportunity Act
AIRD	Associates in International Resources and Development
ATRIP	Africa Trade and Investment Program
BHM	Basic Health Management
CEE	Centre d'Etudes Economiques
CGE	Computable General Equilibrium (model)
CIDA	Canadian International Development Agency
COMESA	Common Market for East and Southern Africa
CREA	Centre de Recherches Economiques Appliquees
DAI	Development Alternatives, Inc.
DRC	Domestic Resource Cost
DTI	Department of Trade and Industry
EAGER	Equity and Growth through Economic and Social Research
ECA	Economic Commission for Africa
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EPZ	Export Processing Zone
ESRF	Economic and Social Research Foundation
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreements
FINSAP	Financial Sector Adjustment Programs
GER	Growth Employment and Redistribution (program)
GTAP	Global Trade Analysis Project
HIID	Harvard Institute for International Development
IBI	International Business Initiatives
IDRC	International Development Research Center
ILO	International Labor Organization
IMF	International Monetary Fund
ISTI	International Science and Technology Institute
MAI	Multilateral Agreement on Investment
MFA	Multi-Fiber Agreement
MISR	Makerere Institute for Social Research
NGO	Non-Governmental Organization
NIEP	National Institute for Economic Policy
PSGE	Public Strategies for Growth and Equity
RER	Real Exchange Rate
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community
SAMS	Social Accounting Matrix
SAPS	Structural Adjustment Programs

SSA	Sub Saharan Africa
STA	Secretariat Technique de l'Ajustement
TIPS	Trade and Industrial Policy Secretariat
UEMOA	Union Economique et Monetaire Ouest Africain
WTO	World Trade Organization

Executive Summary

EAGER Country Workshop Five: South Africa

The fifth semi-annual EAGER Country Workshop was convened in Muldersdrift, South Africa on February 4, 1998. This three day conference provided EAGER researchers, United States Agency for International Development (USAID) staff, and African researchers and stakeholders an opportunity to share research results, discuss on-going research, and react to proposals for new research. In addition to the traditional EAGER themes, the workshop highlighted current issues facing the South African economy including trade and regional cooperation.

The workshop was opened by welcoming remarks by Rashad Cassim, Director of South Africa's Trade and Investment Policy Secretariat (TIPS). Following Mr. Cassim's welcome, brief opening comments were made by the Chiefs of Party for EAGER/Trade and EAGER/PSGE, Mr. Dirck Stryker (AIRD), and Mr. Clive Gray (HIID). Ms. Rita Aggarwal (Economist, Africa Bureau, USAID/Washington) and Mr. Aaron Williams (Director, USAID/South Africa) provided introductory presentations outlining their perspectives and expectations of the EAGER activity.

Following the opening comments of EAGER principals and guests, the heads of the two EAGER cooperative agreements provided summaries of their research and their efforts at policy dissemination. Mr. Stryker gave an overview of the results and general issues which emerged from research undertaken under the EAGER/TRADE Cooperative Agreement, including trade and investment; cross-border trade between African countries; monetary, fiscal and exchange rate policy; and regional integration and cooperation. Mr. Gray described the five broad themes can be identified under the Public Strategies for Growth and Equity (PSGE) cooperative agreement, including ways and means to increase employment and productivity; legal and judicial environment to help the private sector; macroeconomic policy to correct budgetary imbalances; improvement of financial markets; and restarting growth in Africa.

Policy Making, the Private Sector, and the Role of Economic Research, a plenary session, was held after lunch. Three panel discussants made brief presentations on various aspects of these issues:

> **Nora Hill** (South Africa Private Sector) emphasized the radical nature of changes in public-private sector relations since the lifting of sanctions.
>
> **Neal Cohen** (REDSO/East Africa) focused on USAID’s “results orientation” and REDSO’s interest in supporting research which would be done not for its own sake, but to “change the lives of people.”
>
> **Hamet Ndour** (REMIX, Senegal) described the difficulty of limited access faced by researchers in West Africa. He also noted recent, successful consultation between USAID/Senegal and Senegalese researchers on strategic objectives for policy reform there.

Current Issues in the South African Economy followed the private sector plenary session. Three discussants addressed a range of issues facing the South African economy and different ways of viewing them:

> **Asghar Adelzadeh** (NIEP) identified the principal problems of the South African economy as being unemployment and poverty. He concluded that government should take an activist role in attacking these problems.
>
> **Rashad Cassim** (TIPS) supported the macro-economic stability and low government intervention ensconced in the new "Growth, Employment and Redistribution" (GER) policy.
>
> For **Rick Harber** (USAID), the challenges were employment and equity, and he felt that there was scope for government interventions to address these problems.

Restarting and Sustaining Growth and Development in Africa was the first plenary session on February 5. Five presenters and one discussant described research that is being undertaken under that activity:

> **Malcolm McPherson** presented a background and overview emphasizing the underlying issues motivating this research: that it has proven relatively easy to start economic reform, but difficult to sustain it. Many attempts at reform have turned out to be on-again-off-again affairs. Some countries have gone through this process several times.
>
> **Ngure Mwaniki** presented a proposal for research to be undertaken in Kenya. This research will pursue three fundamental questions: Why has growth stagnated during the last two decades? How can growth be restarted? Once restarted, how can it be sustained?
>
> **C. J. Munene** presented a proposal for research in Uganda to assess the process of liberalization by reviewing various economic, political and civil service reforms in that country. The researchers' perspective presumes that although much has been achieved, it has not been enough to transform the growth process. The final question is: what else needs to be done to attain growth rates sufficiently high to transform the country?
>
> **Abdoulaye Diagne** presented an approved proposal for research in Senegal to identify economic and political factors that have blocked growth and suggest ways these might be overcome. The questions he addresses include: How can we boost growth in exports, given that the domestic market is expected to grow only slowly? What is the impact of the exchange rate regime on growth? What have been the principal obstacles to implementing existing policies? What have been producers' perceptions of obstacles to the implementation of policies? and What are the attitudes of policy-makers regarding the Asian experience, and what are their explanations for why Senegal has not performed equally well?
>
> **Arthur Goldsmith** is looking at common themes across the country studies. He feels that there is a consensus on what are right policies, but that few countries do what they say they are going to do for reasons that seem to concern institutions and governance. His research

project aims to get a better handle on institutional problems. One goal is to understand how pressure groups, business or trade associations articulate their needs with policy-makers.

Creating a Network of Policy Research in Africa, the final plenary session, addressed a number of issues. Six presentations were made during the panel discussion:

Diery Seck spoke of the need to create networks of policy oriented research institutions in addition to supporting stand-alone research.

Rashad Cassim pointed out that there are two kinds of research institutions. One does research in-house while the other employs a clearinghouse concept. There is a pool of very good economists on the African continent. How do we link them with the policy making community?

Abdoulaye Diagne pointed out there are already several African networks which work fairly well. We need to understand how they operate and whether there are lacunae among these which this new network would fill. It is true that there is currently a lack of direct links between these regional networks and the national institutions. In order to contribute to capacity creation, it is critical that this pan-African network focus on local issues.

Fred Opio offered a staged approach to the analysis of network building in Africa. First, this networking occurs at the level of individual researchers who ask for an established group with whom they might do policy research. Individuals need to identify or create an institution that will serve this function. Second, there is a need to organize such researchers at the national level.

Dirck Stryker discussed the idea of networks among research centers as seen from the perspective of the EAGER project, itself oriented toward the policy research nexus. One can do independent research and then convene workshops to share results. EAGER has tried something a little different. It builds research directly into the policy formulation process so that the results of the research are eagerly anticipated before the research is even launched, are they are used before the research is completed. The EAGER project has achieved a certain measure of success here.

Clive Gray stressed that HIID is very anxious to participate in the kind of exercise being described here. SISERA is an excellent permanent framework for the network initiated by EAGER. However, while there is a list of proposed members, the criteria for new membership have not been identified. What membership conditions can be set up? What is anticipated regarding a newsletter and conferences or fee based membership? Can foreign institutes be members or participate as observers?

For the remainder of the workshop, EAGER researchers presented the results of their research or, in the case of new research, the description of their research design in parallel sessions on the following topics:

- Global Trade Analysis for Southern Africa
- Barriers to Agricultural Trade
- Legal Regulatory Judicial Reforms and Governance
- Tax Policy Reform
- Promoting an Environment for Private Sector Activity
- Labor Markets, Employment, and Productivity in South Africa
- Contribution of Business Linkages to the Growth of Productive Employment Among Small Enterprises in South Africa
- Reforming Financial Markets in Sub Saharan Africa
- African Trade and Investment in Relation to the Global Economy
- Electricity Trade in the Southern Africa Power Pool
- Financial Intermediation for the Poor

The workshop was smoothly executed and well attended, with over 100 participants.

Equity And Growth through Economic Research (EAGER)

EAGER Country Workshop Five: South Africa

Research and Policy with Application to South Africa

I. Opening Session: Wednesday, February 4, 1998

A. Introductory Comments

Chair: Rashad Cassim (Director, Trade and Industrial Policy Secretariat (TIPS))
Rapporteur: Abdoul Barry (AIRD, USA)

The Chair welcomed participants and visitors to the conference, noting the contribution of EAGER in opening up economic research capabilities in South Africa to world markets. He noted the potential contribution of South African policy research in its home market and to the wider African market.

Dirck Stryker (AIRD, Chief of Party, EAGER/Trade)

Mr. Stryker noted his pleasure to be in South Africa for the fifth semi-annual workshop of EAGER. South Africa's success in integrating economic research with the policy process makes it a particularly appropriate site for this workshop. The key to EAGER's future is how it will evolve in bringing together policy makers, researchers, and the business community. Mr. Stryker proceeded to define the EAGER project objectives as integrating research and policy making to bring about growth and equity in Africa. EAGER is succeeding well in achieving this objective because of the appropriateness of research that is being undertaken under the project and the increasing importance of private sector participation in policy making.

An example of private sector participation is the Corporate Council for Africa which is attempting to create and deepen dialogue between the private sector and policy makers. Notwithstanding this initiative, there remains a need to extend the involvement of the private sector with policy makers and researchers in policy formulation. The prospect for better policy making is to move the center of decision making from the West to Africa.

Clive Gray (HIID, Chief of Party, EAGER/PSGE)

Mr. Gray welcomed participants and, in particular, paid tribute to USAID regarding the difficulty in obtaining Congressional support for funding. He welcomed USAID's support of policy research and he noted the participation of Rita Aggarwal from the Africa Bureau as an expression of this support.

Following his welcoming comments, Mr. Gray provided a brief historical perspective on the EAGER project. The predecessor of EAGER, Cornell University's Food and Nutrition Policy

Project, aimed to assess the impact of structural adjustment in Africa. As a result of this effort, it became clear that what was needed in terms of policy reform was a stronger indigenous capability to undertake and implement policy oriented economic research. Mr. Gray cited his optimism that the current EAGER research agenda is serving that function and that research results will be useful to the policy reform process. In particular, he is optimistic that relationships established between policy makers and African researchers will continue after EAGER.

Mr. Gray also noted the need to think about the next phase of EAGER. His wish in that regard is for greater African participation. Considering the topics we will be discussing in the next few days, it is legitimate to ask how we will follow up the conclusions of the studies through a stronger relationship between policy makers, researchers and stakeholders. Future work will entail moving from the work already undertaken to the implementation stage. Thus, we need a mechanism to enable agencies to use research results.

Rita Aggarwal (Economist, Africa Bureau, USAID/Washington)

Ms. Aggarwal began by welcoming participants and stating that she was pleased to be at the EAGER workshop. EAGER has shown that true partnership between African and U.S. researchers presents inherent difficulties. There are competing pressures on African researchers' time and on U.S. researchers to produce findings, thus creating some frustration for each group.

There are currently twenty five national policy analysis institutions in Africa staffed with top level economists. Strengthening such institutions and increasing the number of trained African economists is of primary importance to the EAGER project. EAGER, working with AERC, IDRC, and other consortiums, has been supporting MA and Ph.D. training programs for economists. The AERC and IDRC programs have strengthened teaching and research capacities in Africa. All of this happened during the past five years and will continue to be a main element in follow-on activities to EAGER.

Effective dissemination, the second main focus of EAGER, grew out of the concern that policy research in the past was not adequately linked to implementation. Research on policy without paying attention to the acceptance and implementation of these findings can be both inefficient and difficult to defend, especially in time of budget constraints.

Advocacy has become a major concern for USAID. Even though EAGER has done well in dissemination through the Webpage and workshop, it will be difficult to establish the causal relationship between research, dissemination and policy implementation. Thus, our challenge is to use the workshop in order to get feedback from participants.

The Clinton Administration is committed to forging stronger US-Africa trade relationships to create new opportunities. Under the Africa Trade and Investment Program (ATRIP), USAID will fund in 1998 $4 million worth of technical assistance related to tax and tariff reform, privatization, and deregulation of the investment environment. Another $1 million will be used to strengthen business partnerships between African and U.S. private sector organizations.

Ms. Aggarwal noted the comment made by Jerry Wolgin, Director of USAID's Office of Sustainable Development during the EAGER workshop in Washington, DC to the effect that he was bullish on Africa. His bullishness derived from the strong performance indicators in Africa over the years preceding 1996. However, we need to ask ourselves if the strong growth observed in Africa is sustainable and what its sources are. She encouraged workshop participants to reflect on this.

Aaron Williams (Director, USAID/South Africa)

Mr. Williams noted the likelihood that USAID would continue to support EAGER research and cited the need to convince Congress of its importance. The partnership between African and U.S. researchers is extremely important and can help to ensure that the relationship between African researchers and African policy makers contributes to policy reform.

Mr. Williams noted that we need to distinguish between short term and long term objectives in our work. In the short term, we can focus on facilitating and training. In the long term, there is a need to promote growth and development by incorporating employment generation, increasing productivity and improving financial intermediation.

B. Summary of EAGER Research

Chair: Diery Seck (IDRC)
Rapporteur: Abdoul Barry (AIRD)
Presenter: Dirck Stryker (AIRD)
Presenter: Clive Gray (HIID)

Following the opening comments of EAGER principals and guests, the heads of the two EAGER cooperative agreements, Clive Gray and Dirck Stryker, provided summaries of their research and policy dissemination efforts to date.

Dirck Stryker, Chief of Party, EAGER/Trade

Mr. Stryker did not go through each study of EAGER/Trade, but instead gave an overview of the general issues which emerged from the results. In his view, the following categories of topics were important: Trade and investment; Barriers to cross-border trade; Monetary, fiscal and exchange rate policy; and Regional integration and cooperation.

Trade and investment covers several countries including Mali, Uganda, and South Africa. An over-arching issue in this research is the rapid change of the global economy and globalization and the impact of this on Africa's trade prospects. Globalization implies that transport costs are declining, and that there is greater facility of communication and information and this is shifting knowledge. The danger is that Africa is lagging behind the rest of the world and thus runs the risk of marginalizing itself. Policy is key, in this respect, as shown in the econometric analysis. Analysis indicates that policy is even more important for Africa than other regions in the world.

Institutional constraints constitute a major impediment in Africa and these contribute to high transaction costs there. Institutional problems are in customs procedures and import processing (it takes three weeks to clear customs in Africa while the same operation takes only ten minutes in Singapore); lack of access to trade finance; and the legal and judicial environment. Overcoming these problems will require a strong commitment from policy makers. Marginalization of Africa is an important issue that needs to be addressed.

Cross-border trade between African countries covers several Sahelian countries as well as several in Southern and Eastern Africa. This research has identified many informal barriers, including 30 barriers between Bamako and Abidjan; problems of payment with long delays among CFA countries and between them and non-CFA countries; protection of domestic producers; and arbitrary procedures. Overcoming these constraints would require a better organization and diligence from the private sector. In fact, it is getting organized in some African regions but it is not strong yet. A case in point is the West African Enterprise Network.

Monetary, fiscal and exchange rate policy studies cover Ghana and Uganda. In Ghana, the exchange rate is used to combat inflation. Thus, the Central Bank is under tremendous pressure to lower inflation and the real exchange rate. Meanwhile, Uganda faces external shocks and there are limited policy options. In the fiscal area, there are two majors problems: fiscal imbalance leading to inflationary pressure, and weakness of tax base.

Tax revenues are generally limited to the proceeds of taxes on trade, but these taxes have the less desirable result of decreasing returns to exports and increasing incentives for import-substitution. In Ghana, the recommendation has been to lower the tax rates in order to increase collection. High tax rates have lead larger firms to cut deals with government. Such ad hoc enforcement of tariff rates raises obvious questions about equity and transparency.

Regional integration and cooperation. Steve Radlet of HIID has written a useful paper that documents trade diversion in Africa and the subsequent implications for trade creation. The failure of regional integration and the potential gains of regional cooperation were highlighted. Power sharing in southern Africa is an example of gains to regional cooperation in Africa. A study showed enormous gains from power sharing. Without infrastructural investments gains were to be on the order of $6 billion. With infrastructure, there are additional gains of $1 billion. Within this framework, one needs to look at gains to consumers and other impacts of improved regional cooperation. There are also opportunities for gain in the informal sector. Still, distributional impacts of power sharing should also be looked at. The results of this study will be presented in Lusaka.

Clive Gray, Chief of Party, EAGER/PSGE

Because PSGE is everything but trade, it is difficult to synthesize but, basically, there are five broad themes:

- Ways and means to increase employment and productivity
- Legal and judicial environment to help the private sector
- Macroeconomic policy to correct budgetary imbalances

- Improvement of financial markets
- Restarting growth in Africa

The consortium of EAGER/PSGE is composed of eight US-based institutions (six of them are represented at this workshop) and 40 African researchers (15 of whom are represented at this workshop). Studies currently approved under the PSGE cooperative agreement include:

Increasing labor demand and productivity in Ghana and South Africa.

The cost of doing business: The legal-regulatory-judicial environment in Ghana, Madagascar and Tanzania.
Financial intermediation for the poor.

Enhancing transparency in tax administration.

Improving the framework for monetary programming.

The impact of financial sector reform on bank efficiency and financial deepening for savings mobilization.

Tax policy in Sub Saharan Africa: The role of excise taxes.

The contribution of business linkages to the growth of productive employment among micro and small enterprises in South Africa.

Restarting and sustaining growth and development in Africa.

If funding is available, the following research topics will be pursued:

The development of capital markets and growth in Sub Saharan Africa.

Competition policies for growth: Legal and regulatory framework for Sub Saharan African countries.

For EAGER/PSGE, Mr. Haji Semboja (ESRF, Tanzania) provided a brief description of research undertaken through the *Legal, Regulatory and Judicial Reform* research theme. This intervention had three components: research, capacity building, and policy.

The research methodology used by ESRF is multi-disciplinary. The capacity building component included two policy workshops and involved policy makers, mass media, researchers, and private sector stakeholders. The purpose of the workshops was to disseminate results. During the workshops, policy makers were invited on individual basis and did not represent their affiliated institutions. The first workshop centered around law issues and included academicians, two ministers, one from the President's office and one from the Ministry of Trade, and the private sector. Written comments were requested from the ministers. Papers were distributed well in advance and comments were received during the workshop. After the workshop, the results are sent to all stakeholders and then several documents are produced on policy dialogue. Follow-up is planned to assess whether or not the government has accepted the ideas presented.

Questions and comments from the floor

Q. Don Mead: Are papers distributed before the workshop? How do you manage to receive comments from ministers?

Q. Marios Obwona: Are the problems in Africa related to governance?

R. Haji Semboja: Ministers provide comments because the new ones are professionals who have learned to share ideas and the research topics are not purely academic, but problem-solving. ESRF was created to bring private sector and policy makers to dialogue and as a result it is not seen as a threat to anyone.

R. Dirck Stryker: Governance and transparency are important, but the big issue is the tendency to set tax rates too high. There have been efforts to simplify the tax code, but because of these high rates not very many firms pay taxes. It is shown that not even half of the taxes are collected because of the various exemptions. Another issue is how decisions are made. It appears that they are discretionary and not transparent because the deal is set and big firms do not pay. Small firms also have ways to circumvent these high rates. They make deals with the government. The consequence of all of this is it becomes difficult for firms to operate because of the uncertainties surrounding implementation. What is the solution? Reduce tax rates as was done in Kenya. There, after the rate reduction, more revenue was collected.

Q. Patrick Meager: Is there any evidence of fairness in tax enforcement and the impact of expenditure policies?

Q. Where do African policies come from? Before independence, they came from outside. EAGER needs to push for home-grown thinking to strengthen local capacity in order to find originality in solving problems. Policies are not bad and Africans are quite capable of designing good policies. The problem is in implementation.

Q. Margaret McMillan: Was disappointed by the lack of studies on distributional aspects.

Q. Mike Unger: How far along is Dirck in addressing the supply side economics in his research?

R. Clive Gray: Several of the studies involve assessments of income distribution and seek to increase income earning opportunities of marginalized people. For instance, financial intermediation touches on distribution. Under high inflation, the poor segment of the population loses the most; thus, distribution is implicitly incorporated.

R. Dirck Stryker: His study is not really on fairness and decentralization. To him, it is important to learn about history to know about the origin of bad policies. Prebish launched the idea of protection against imports under the infant industry argument. It was not until the late 1960s that studies showed the danger of this dogma. After independence, a lot of countries needed to

increase revenues in order to finance the embassies opened by developing countries. Then came the oil crisis, followed by the commodity boom of the mid 1970s, and at the end of the 1970s and beginning of the 1980s came the problem of debt repayment. After long budgetary deficits which were not sustainable, came Structural Adjustment Programs to address this issue.
Supply side economics is about lowering taxes to boost private sector activities. Ultimately, more revenues will be collected by the government to fill the budgetary gap and finance growth. The results were contrary to the idea held because the budget deficit increased. It was not until recently that the balanced budget came about. In his study, he is not dealing with supply-side economics, but compliance with paying taxes through lowering the tax rates.

Q. Lucie Phillips: The sector which was neglected was mining. The reservation wage in this sector was six times higher than that of agriculture because of the policies in place in Tanzania. With the reform of the mining sector in Tanzania, anyone can sell diamond and gems. The exchange rate was freed. Ghana, Mali, Eritrea, and Angola reformed their mining sectors. Why can big corporations mine and the small informal sector not?

Q. Dunstan Spencer: The focus has been on tax collection and whether the private sector is really paying its taxes. He thinks that the issue needs to move to increasing incentives to tax collectors.

Q. Nora Hill: Has there been any research to understand the working of policies? How to change people's minds?

Q. We need to address the problem associated with policy unpredictability in Africa.

Q. Pépé Andrianomanana: two points to be made: (i) What are the growth factors? The study on the Asian experience does not really address this issue and EAGER needs to take a closer look at it; and (ii) Transparency is assessed in studies under EAGER/PSGE, but do we have any idea of tax elasticities?

Q. Daniel Ramarokoto: Two questions to the researchers: How can they integrate policy makers' need into their studies? Are they addressing the lag dimension in people's reactions to policy changes?

Q. What is more efficient? Integration or cooperation?

R. Dirck Stryker: In dealing with compliance, one does not just lower taxes. Three elements need to be taken into account: reduction of tax rates, administration of taxes, and collection of taxes

II. Policy Making, the Private Sector and the Role of Economic Research

Chair: Asghar Adelzadeh (National Institute for Economic Policy (NIEP))
Rapporteur: Will Masters (Purdue University)
Presenter: Nora Hill (South Africa Private Sector)
Presenter: Neal Cohen (USAID/REDSO)
Presenter: Hamet Ndour (REMIX, Senegal)

The Chair's opening remarks emphasized that the South African experience provided much material for discussion and debate.

Nora Hill

Nora Hill's presentation emphasized the radical nature of changes in public-private sector relations since the lifting of sanctions. Under sanctions the country had a "laager" mentality, with government and private sector focusing on import substitution. Opening of markets in the 1990s was a shock, as companies proved to be less competitive than had been expected. Previously companies had been competitive (that is, profitable) on a protected domestic market or on the world market with export incentives. As those incentives were withdrawn it became clear that large-scale changes were needed. For example, the wood-using industry is being undermined by direct exports of timber, which is more profitable than selling the timber locally. In this context much research is required to identify what activities will be competitive.

Neal Cohen (REDSO/East Africa)

Neal Cohen's comments focused on USAID's "results orientation", and REDSO's interest in supporting research which would be done not for its own sake, but to "change the lives of people." Research would increasingly be judged by the policy changes it brings about, rather than the research itself. Buff McKenzie, former mission director in Madagascar, has drawn attention to the need to avoid "research for its own sake" and the need to undertake forward-looking research on urgent issues such as:

- The need to comply with WTO obligations over the next three to seven years in South Africa, Mauritius, and others, particularly when other countries will not be making these changes;
- The May 1998 meetings on the Multilateral Agreement on Investment (MAI), which will have major implications for developing countries; and
- The consequences of HIV/AIDS, when infection and mortality rates can be predicted and will have massive effects that have not been investigated.

REDSO/East Africa is particularly interested in "cross-cutting" research that involves many disciplines, and the U.S. - African Trade and Investment Initiative is a particularly important new activity of which people should be aware.

Hamet Ndour (REMIX, Senegal)

Hamet Ndour introduced himself as director of a consulting firm in Senegal, who works mainly in microfinance and microenterprise. He noted that Senegal, along with seven other West African countries, manages monetary and fiscal policy through the UEMOA central bank but manages other economic policy through the national government. The central bank is largely closed to outside researchers. For example, it refused to participate in the EAGER-funded work. The national government is often directed towards serving special interests. Private sector business leaders do have effective organizations, but their interests often differ so they cannot speak with one voice. Organizations involving the informal sector have, however, been effective recently, particularly in obtaining repeal of the VAT. Finally, it is important to note that donors often have a prespecified agenda, asking local consultants to do research that justifies their view, so that the local researchers have a choice between being objective (and not getting hired) or doing the work (and not being objective). On a positive note, USAID/Senegal's recent efforts to draft their strategic objectives have involved much consultation with Senegalese researchers, which has been successful.

Questions and comments from the floor

Asghar Adelzadeh underlined the differences in perspective of the panelists, noting that although USAID may want its research to have an immediate impact, Hamet Ndour's comments showed difficulty in identifying that impact, and the degree to which research may have its greatest impact when it is aimed at the wider public debate over policy issues.

Edwin Bbenkele: There is often a great gulf between businessmen and policy makers, which is hard to overcome.

Nora Hill: Businesses need to coordinate among themselves to compete overseas. The influence of cotton and auto industries could be due to its good organization. South Africa's clothing and auto industries have been particularly effecting in lobbying government.

Dirck Stryker: There has been a fundamental change in African business activity, from a focus on lobbying their own governments to a focus on economic analysis and anticipating change. This allows firms to shift from competing against each other for government privileges to working together in pursuit of common goals. The West Africa Enterprise Network is a good example. The question is, how can researchers work with these groups of firms to help them achieve social goals?

Don Mead: Research covers a broad spectrum of work, from very narrow to very broad. When the research asks specific questions requiring focused answers, private-sector researchers may be best placed to respond.

Lynn Salinger: Private researchers can help identify changes in competitiveness, as firms often know a lot about their industry but not a lot about broad trends. For example, many industries are shifting from competition based on price for a given commodity to competition based on quality and customized production requiring rapid information flows.

Mike Unger: The business community did support the West Africa Enterprise Network, but a consulting firm was the catalyst for it. As Africa matures towards democracy, academics and business people will play an increasing role in policy making.

Neal Cohen: REDSO/East Africa will focus on work with a regional dimension and on work that is oriented towards sharing resources to achieve goals set by strategic thinking. It will be required that ideas and implementation be African-led. The link between governance and economic performance is a good example of an important cross-cutting theme that involves all types of research.

Andrew Sisson: As African countries democratize, a much wider group of stakeholders will become involved in policy making, so policy-oriented research will need to reach a wider audience to influence the policy debate.

Ngure Mwaniki: USAID has reached out to the private sector much more than the multilateral agencies. A new generation of Africans have begun to identify their interests with the national interest.

Patrick Meagher: Collective action to effect policy change is very costly, so where business leaders see little potential gain they will not engage in policy lobbying. The key to making policy debates more relevant is to improve governance. One example is the Robert McNamara work on “islands of integrity”.

III. Current Issues in the South African Economy

Chair: Daniel Ndlela (Zimconsult)
Rapporteur: Malcolm McPherson (HIID)
Presenter: Asghar Adelzadeh (NIEP)
Presenter: Ric Harber (USAID/South Africa)
Presenter: Rashad Cassim (TIPS)

Asghar Adelzadeh

Mr. Adelzadeh noted that the principal problems of the South African economy are jobs and poverty. The job problem is that more than 35 percent of the labor force is unemployed. The poverty problem is that livelihoods are unsustainable. Hence, the focus on job creation and poverty alleviation. Such a focus would target structural constraints and the macroeconomic policy framework.

Structural constraints include: (i) low growth; (ii) extreme income inequality (and consequent distortions in markets for goods and services); (iii) the organization of the South African labor market – inherited from past policies; (iv) landlessness; (v) persistent unemployment; (vi) rigid organization of workers; (vii) job insecurity and (viii) high capital intensity. In addition, many institutional and legal factors constrain the labor market.

The macroeconomic policy framework is not conducive to employment creation. Jobs are being shed as the economy restructures under the adjustment program. The private sector is being called upon to create jobs through agricultural and industrial policies.

What needs to be done? South Africa needs to rethink the policy framework by adopting a growth orientation and by trying to achieve a better distribution of income. This will require an active role for government. The question is how to shift the "potential capacity" through government intervention. Since excess capacity exists, Keynesian stimulus would reduce unemployment. Fiscal, monetary, and exchange rate policies could reduce poverty and promote growth.

South Africa needs to focus on human resource development and to encourage job stability. We need to increase labor intensity while still ensuring worker protection and worker rights. This might entail developing incentives for job creation. And, finally, we must improve opportunities in agriculture. Given that jobs are not currently being created at an adequate rate, there is a long way to go to eliminate poverty. Employment creation and poverty alleviation are directly linked.

Rashad Cassim

Mr. Cassim focused his comments on trade aspects of the South African economy. South Africa has features of a middle income country including a diversified industrial base and a narrow trade structure. Under the government's current economic policy document, *Growth, Employment, and*

Redistribution (GER), the focus is on manufactured exports. However, manufactured output has declined and some labor is being shed.

In terms of policy, how far has government gone? Trade liberalization is seen as a source of employment reduction. There are many customs leakages. But, in practice, liberalization has not gone very far. An overvalued real exchange rate has inhibited adjustment and micro infrastructure issues and spatial problems raise transactions costs.

Challenges for South Africa are to develop a more rational link between trade reform and labor market issues; and to focus more narrowly on the role of interest rates, exchange rates and how these impact trade incentives.

Ric Harber

For Mr. Harber, the challenges are, again, employment and equity. We can define the present from the past, the challenge is what to do in the future. In the 1970s and 1980s there was growth which permitted increases in both real wages and employment.

How can South Africa promote employment growth? Public works and such similar Keynesian stimulus may be recommended. In addition, however, there is a need to change the structure of the labor markets to reduce unemployment. Since 1994, even with improved growth rates and rising investment to GDP ratios, formal sector employment has declined.

What are the explanations? Perhaps the data are wrong. Perhaps the shedding of labor is a temporary adjustment to the re-opening of trade. Perhaps it is explained by increased use of subcontracting as a means for obtaining goods and services. Unions are pushing to re-open the debate over labor policy, but GER should provide the framework for policy development.

South Africa needs investment to promote growth rates of 6-8 percent per annum Most of this will have to come from abroad. Cutting the fiscal deficit will help.

Questions and comments from the floor

Q. Is government too involved in business? How can a compatible business environment be created? Why are there remaining spatial restrictions on business location? Can there be a strategy of “pull up” rather than “push up”?

Q. It will be difficult to sustain growth with fiscal deficits as high as South Africa's! Job losses are occurring as tariffs are being adjusted. South Africa needs job market flexibility. There is not enough research on this. How do you square declining employment with excess capacity? What has been the investment performance? What are the reasons for low capacity use?

Q. How do you balance price stability with promoting export competitiveness while avoiding the debt trap? What about micro credit as a poverty reduction strategy? What are the formal/informal financial linkages?

Responses

There has been higher growth in manufacturing sector. Less labor has been shed than would have been the case. The GER projects a high rate of exports 10 percent per annum, but in 1998 the growth was only 2 percent. Exports are 27 percent of GDP. It is difficult to have such a large sector expand by 10 percent per annum.

Better income distribution would help domestic growth since it would redirect expenditure to products which have high labor intensities. Equity promotes growth!

The role of government should be to reduce the deficit. This would encourage private investment. Spatial incentives are different now from what they were in former times. Even if exports are capital intensive are there knock on effects to the domestic sector of higher exports?

Excess capacity existed because South Africa was formerly a closed economy. Post-apartheid changes released the constraints. Previously, producers were forced to reinvest. There were many white elephants and net investment was very low. Now, South Africa needs replacement investment to adopt new technologies.

High domestic debt, more than 50 percent of GDP, is keeping interest rates high and debt service high. This limits discretionary government expenditures.

Discussion

Q. A tight monetary policy combined with a loose fiscal policy is insane. Export expansion is necessary for secondary expansion.

Q. The reservation wage in South Africa is quite high especially relative to neighboring countries. Labor costs are too high.

Q. South Africa needs to upgrade its skills but government is proposing a “training fee.” The policy should be the opposite.

Q. It has been said that employment cannot be created because wages are too high, but that poverty is high because wages are too low. How are these consistent?

Q. What sort of integration is there between the formal and informal labor markets?

Q. There has been no discussion of agriculture. The government has dismantled the marketing boards. Surely there must be possibilities to increase labor intensity through cheaper food processing. Lower food costs would improve equity.

Q. What about the small and medium enterprises? Is their expansion bad or good?

Responses

One problem is that the Reserve Bank is driving monetary policy. There has been enough study of the labor market. Action is needed. Lower food costs would help equity and employment. The informal sector in South Africa is much smaller than elsewhere (50 percent of household income comes in lower 20 percent of income scale comes from wage labor). The push for agricultural output would have a large impact on employment. The input/output table shows there are very strong employment linkages from agriculture.

IV. Restarting and Sustaining Growth and Development in Africa

Chair: Daniel Ndlela (Zimconsult)
Rapporteur: Donald Mead (Michigan State University)
Presenter: Malcolm McPherson (HIID)
Presenter: Ngure Mwaniki (M.A. Consulting)
Presenter: J. C. Munene (MISR)
Presenter: Abdoulaye Diagne (CREA)
Presenter: Arthur Goldsmith (HIID)
Discussant: Diery Seck (IDRC)

Five presentations were made under this session, beginning with an overview of the research theme by Malcolm McPherson.

Malcolm McPherson

Mr. McPherson emphasized the underlying issue motivating this research: that it has proven relatively easy to start economic reform, but difficult to sustain it. Many attempts at reform have turned out to be on-again-off-again affairs. Several countries have gone through this process several times.

The research has two complementary parts: thematic studies, and country studies. The thematic studies are under three headings: politics and institutions, macroeconomic management, and productivity. At the country level, three approved research efforts will be reported to the workshop. Several others researchers are preparing additional proposals.

Mr. McPherson indicated that the process of turning this broad agenda over to local researchers has not been easy. The long-range goal is high, sustained rates of growth. A shorter-term goal is getting higher growth onto the political agenda.

Ngure Mwaniki

Mr. Ngure Mwaniki presented a proposal for research to be undertaken in Kenya . This research pursues three fundamental questions: Why has growth stagnated during the last two decades? How can growth be restarted? Once restarted, how can it be sustained?

Mr. Mwaniki indicated that the main challenge will be in the area of political and institutional analysis. The researchers intend to include an examination of the role of ethnic conflicts in policy-formulation and implementation. They will also explore issues of productivity, particularly looking at the productivity of labor and the impact of trade incentives on productivity. The researchers intend to focus primarily on internal factors and less upon external issues.

They expect to adopt a very results-oriented approach to the research and will undertake dissemination of research results through one-day seminars with top policy-makers.

C. J. Munene

Mr. Munene presented a proposal for research in Uganda. He started from three principles: if it works, it is obsolete; tomorrow will not look like today; and there is a serious problem of researcher fatigue.

Uganda is seen by many as an on-going success story. This sets the framework for their analysis, where the first question to be addressed is: what has been done? This means reviewing the various economic and political reforms as well as civil service reforms already completed. The researchers' perspective presumes that much has been achieved, but that what has been done to date has not been enough to transform the growth process. For that, the growth rate must be raised from a current level of about 6 percent to above 8 percent. The question, then, is what else needs to be done to attain growth rates sufficiently high to transform the country?

In terms of macro management, the question is: What has made it possible to achieve what they have done? Has the sequencing been correct? What other policy prescriptions are needed?

In regard to institutions, are the new institutions that have been created compatible with the existing behavioral patterns and supportive of the policies being introduced? (Examples were given: the foreign exchange market, Makerere University)

On the question of political reform, the issue is: Will the reform be sustained? Can it control corruption? Without that, the economic reforms will not last.

Abdoulaye Diagne

Mr. Abdoulaye Diagne presented an approved proposal for research in Senegal. In this case, the goal is to identify economic and political factors that have blocked growth and suggest ways these might be overcome. Among the factors to be emphasized:

- The growth of exports will be the most important source of growth, since the domestic market is expected to grow only slowly.

- What is the impact of the exchange rate regime on growth?

- Regarding policies adopted up to now, what have been the principal obstacles to the implementation of these policies?

- What have been producers’ perceptions of obstacles to the implementation of policies?

- What are the attitudes of policy-makers regarding the Asian experience, and what are their explanations for why Senegal has not performed equally well?

Arthur Goldsmith

Mr. Arthur Goldsmith looked at common themes. He feels that there is a consensus on what are right policies; but few countries do what they say they are going to do. The answer seems to concern institutions and governance. His research project aims to get a better handle on those institutional problems.

One approach has been to see the problem in terms of rent-seeking (corruption) that blocks, paralyzes and frustrates change. The response may be in a move towards more open, transparent processes, so that closed decision-making patterns can be challenged. A paradox is that institutions can block change, but can also be instruments to effect change. One goal is to understand how pressure groups, business or trade associations articulate their needs with policy-makers.

Diery Seck, Discussant

The discussant had general comments and comments on two of the country proposals. On a general level, he asked about the terms of reference for the country teams, indicating that these might not have been written in a collaborative mode, which is too bad. He indicated that the approach appears to take the World Bank's Structural Adjustment Programs as the standard. The question is: why so, when there seems to have been so many cases of such programs being poorly implemented? It would be useful to evaluate this question, and to assess alternative approaches.

He also suggested that the approaches proposed were incomplete in that Senegal seemed to leave out foreign trade issues, while Kenya left aside fiscal policy. In particular, fiscal policy seems to be downplayed in both, while it is an important factor. Finally, he suggested a separation between the needs of short-term growth vs. long-term growth. They may be different. Policy-makers may say they are doing all the right things to achieve short-term growth while ignoring the more fundamental things needed to achieve high long-term growth.

Looking at the Senegal proposal, Mr. Seck suggested a separation between export growth and the overall foreign exchange regime. Both are important. He felt that the approach was like that of a police inspector: there has been a crime, who is guilty? Finally, he indicated that it would be difficult to get hard results from the types of soft data to be collected.

For Kenya, Mr. Seck indicated that there is too much emphasis on monetary issues, not enough on trade and fiscal questions. He found the discussion disjointed and said it would benefit from looking for unifying themes. On the productivity issue, he suggested the use of production function analysis as a way of pulling the various elements together.

Questions and comments from the floor

C. Clive Gray indicated that this is the largest, most complex and most ambitious component of the PSGE agenda. One point of interest will be to compare the approaches and results across countries. He also indicated a hope that other countries might be added to the list of those examined, probably through separate funding in a possible extension of the EAGER project or through another, similar project.

Q. In Uganda, the UNDP is engaged in a similar study; is there overlap? There is little attention to income distribution, a factor that can hinder growth. There may be a need for a unifying framework for the analysis.

Q. There must be a balance between stabilization and growth. This is serious because the stabilization phase sometimes lasts for six to eight years with growth promised only at the end.

Q. Several questioners asked about plans to ensure that the results will be implemented. One aspect of this concerned involvement of the multilateral donors who still are important players and may have a different agenda.

Q. Another question emphasized the issue of fiscal imbalance in Kenya and the problem of fixed exchange rates in Senegal.

Response

The presenters responded by indicating that the main clients are public servants, and there are formal and informal mechanisms for interacting with them. The issue of foreign aid dependence needs to be addressed. Much of the analysis will be more qualitative than quantitative. Policy-making up to now has often been reactive rather than proactive; there will be a major effort to change that.

V. Parallel Sessions: Thursday Morning, February 5

Three sessions were presented simultaneously, including: Global Trade Analysis for Southern Africa; Barriers to Agricultural Trade; Legal-Regulatory-Judicial Reforms and Governance.

A. Global Trade Analysis for Southern Africa

Chair: Temba Mhlongo (DTI)
Rapporteur: Daniel Ndlela (Zimconsult)
Presenter: William Masters (Purdue University)
Presenter: Inyambo Mwanawina (University of Zambia)
Presenter: Robert Davies (University of Zimbabwe)
Discussant: Dominique Njinkeu (AERC, Kenya)

William Masters, *Global trade analysis for Southern Africa.* (Interim Report)

Mr. Masters explained the Global Trade Analysis Program (GTAP) model. This program is based on:

- a database that disaggregates global production and trade for 45 countries/regions and 50 commodities/sectors;
- modeling software that is capable of simulating changes in policies, resources or technologies, particularly with trading partners; and
- two-way links with a global network of researchers.

GTAP is well documented and easily extended to simulate the impact of changes in policy, resource, or technology implemented through the GEMPACK model.

For the current research, the GTAP model was segmented into: SACU (as one entity); and Rest of Southern Africa (RoSA) defined as SADC minus SACU. A database was created to simulate trade within these groupings. Data were sourced from country governments (input/output tables, SAMS, National Accounts), UN COMTRADE, and UNCTADs TRAINS data set. With similar additions of data, the model is ready to take other countries or groups of countries such as COMESA and central African states (ECCAS).

Inyambo Mwanawina, *The impact of capital flows to South Africa*. (Final Report)

Mr. Mwanawina presented an empirical assessment of the impact of capital flows within SACU and RoSA and analyzed the implications of those flows in the context of the sub regional integration. His research examines the consequences of capital inflows for real exchange rate (RER) appreciations, import dependence and variability of RER and trade balance and adjustment patterns for the regional partners. In his simulation, using the GTAP model to measure individual country risks, capital flows were estimated under the simplifying assumption that there are no import tariffs on trade between SACU and RoSA.

The analysis leads Mwanawina to conclude that capital flows into South Africa would increase labor absorption and growth, and spillover effects in neighboring countries would be nil. In regard to the latter finding, domestic economic reforms within RoSA would be needed for them to attract higher investment levels within the group.

Rob Davies, *The impact of SA-EU and SADC free-trade agreements*. (Final Report)

Professor Davies applied a multi-sector, multi-country computable general equilibrium model to simulate internal and external impacts of free trade agreements in southern Africa. These simulations used South African import data on RoSA, rest of SSA, EU and ROW, for selected sectors. Different tax and tariff scenarios were simulated to show changes in import quantities from the EU and different welfare effects of different SA-EU free trade agreements (FTAs).

The simulation indicates that partial FTAs affect trade in products not covered by the FTA, and that the SA-EU FTA for South Africa could yield strong trade diversion effects and weak trade creation effects. They also indicate benefits from gradual tariff reductions in SA and strong trade creation effects for the EU. On the other hand, a SA-SADC FTA would yield trade creation possibility, but small volumes will yield low returns. Removing intra-regional trade barriers would improve overall benefits.

Dominique Njinkeu, Discussant

The discussant extolled the GTAP model as an important tool in helping Africa to avoid the policy-induced marginalization from world trade that other speakers have warned about. In particular, Mr. Njinkeu was enthusiastic about the possibility of estimating welfare impacts of policy changes vis-a-vis trade and investment. He went on to raise the following questions:

- What is the impact of GTAP modeling in the face of the weak position of the Southern Africa region in the world trade?
- How far will the model analyze the constraints in the domestic economy?
- How can GTAP be developed into a dynamic model to take account of impediments to trade faced by the African region?
- What can the model tell us about the welfare impacts within countries and across countries?

Questions and comments from the floor

Q. Can the model also take account of trade outflows? What about intrafirm transfers?

Q. How can countries and regions join in the GTAP framework?

The presenters explained that the model would take care of internal matters such as agriculture and transport costs. Intrafirm transfers between countries must be captured in the data-set. It was also noted that the GTAP model is somewhat weak in explaining changes in the financial sector.

The presenters stressed the administrative problem in regard to data. These problems can be thought of as supply side issues and are resolved by researchers who join up with the GTAP program. Data, once developed, become a public good.

The model is meant to assess resource allocative effects of changes in global trade, but it is weaker on the macro side. It is understood that this is not the whole story. The robustness of the GTAP model is driven by the fact it can handle changes in the elasticities of substitution.

B. Barriers to Agricultural Trade

Chair: Dunstan Spencer (Dunstan Spencer Associates)
Rapporteur: Lucie Phillips (IBI)
Presenter: Fred Opio (EPRC, Uganda)
Discussant: Neal Cohen (USAID/REDSO, Kenya)
Presenter: Abdoul Barry (AIRD, USA)
Discussant: Abdoulaye Diagne (CREA, Senegal)

Fred Opio, *Comparative advantage and intraregional trade for Uganda's non-traditional export commodities–Uganda, Tanzania, Kenya and Rwanda case studies*.

Uganda is becoming a hub for regional trade in non-traditional exports. This is important, particularly given that Uganda's overall balance of trade was negative during the period 1989-1995. Imports out paced exports in value by a ratio of two-to-one during much of that period. Data on Kenya-Uganda trade were provided, showing a sharp imbalance towards imports into Uganda from Kenya. This imbalance has diminished somewhat in recent years but trade is still heavily weighted towards exports from Kenya to Uganda.

Significant trade reforms were initiated in the early 1990s, including liberalization of the exchange rate regime, elimination of export taxes and reduction of import tariffs, and a reduction on non-tariff barriers to agricultural trade. One of the most visible results of these changes in trade policy has been growth in exports from Uganda of maize and beans. This trade has been supported by donor purchases of crops as a part of regional food aid activities.

There has been considerable volatility in product prices for these goods and this has generated volatility in export volumes. Price volatility is, therefore, an important component in the research described by Mr. Opio. There have already been a number of studies on marketing and production of maize and beans in East Africa and these will be mined for data and analysis.

The current study will generate domestic resource costs for these commodities and will measure marketing costs. It will then compare these costs with border prices. Trade competitiveness will be assessed in terms of gross margins to producers and net financial benefits to exporters. Finally, the effective protection coefficient for these commodities will be estimated and used, presumably, to show the impact of government trade policies and other subsidies or costs on trade.

The goal of this research is to explicitly analyze the situation in the countries of the region and to derive policy implications from these analyses. The research should help to develop recommendations for improving: the implementation of policies; marketing intelligence and information diffusion; the predictability of trade; modifications of border administration; and internal trade controls and administration of customs. It might also help to inform bilateral trade discussions and might generate an increase in private sector investment in marketing functions, both on and off farm.

Neal Cohen, Discussant

The discussant focused attention on the question Who are the clients and what do we or they want out of this study? He felt that the list is currently too extensive. Mr. Cohen also felt that the objectives were overly numerous and should be limited. He wondered how the research could achieve the goals discussed? How will we get those policy changes? He noted that research is a necessary but not sufficient condition.

In particular, Mr. Cohen was concerned that the advisory committees are composed of the same people responsible for the existing policies. They created the problem. Perhaps we need to go beyond this group to solve the problem. Do NGOs have a role? How can we involve disadvantaged groups and address equity issues?

Mr. Cohen cited research undertaken in a 1993 Comparative Advantage study which showed maize and beans to be produced at least cost in Tanzania and Kenya. How has the comparative advantage changed? Why?

Mr. Cohen called for making this study a part of a package: from research to end policy result. REDSO has done a lot of regional trade work. Much of this shows that informal trade is greater than formal, and that this trade often happens in the opposite direction (formal one way and informal the opposite way). Account needs to be taken of this. In brief, one should not base the study on formal figures.

Abdoul Barry, *Promotion of Mali's rice exports toward the West African market.*

AIRD has been working with the Club du Sahel since 1990. Their work there showed that most West African countries are not competitive in rice at world market prices except in the interior countries, for locally consumed rice. However, this changed radically in 1992 when Mali liberalized its rice sector. Yields jumped from 2 to 4 tonnes per hectare to 8 to 12 tonnes per hectare. Malian firms began exporting rice to Guinea at that time.

The January, 1994 devaluation changed the picture by making Malian rice even cheaper in the other West African countries. Suddenly Mali was exporting rice to Burkina Faso and Cote d'Ivoire. USAID asked for a study in 1995. This study addressed several questions. Does Mali have a comparative advantage in rice production in region? If yes, what are the prospects for rice supply and demand. Is trade sustainable? Is rice marketing efficient and what are the cost increasing constraints to rice exports?

Using a domestic resource cost (DRC) approach, various national and sub-national markets were assessed to see who had comparative advantage in rice. It was found that all of Mali's domestic market enjoyed comparative advantage for home production. For Guinea, Malian production was found to have a comparative advantage in part because transport costs from Conakry are much higher than those from the interior (back loading.) In Cote d'Ivoire and Senegal, only frontier provinces could be more cheaply served by Malian producers.

Incentive structure of rice marketing. Financial profitability in Mali is relatively high, especially relative to Senegal. Malian rice is not competitive in Niger largely because of the impact on that market of food aid. The incentive structure of these markets are not favorable to Malian exports into the interior of neighboring countries.

Sustainability of rice supply. There is considerable debate about the demand assumptions (per capita rice consumption) used to generate food security estimates. The two different estimates used for this study were 25 kilograms per capita and 34 kilograms per capita. Mali shows a rice deficit through 2005 even using the 25 kilograms figure. Because of this, Malian exports may not be allowed. Seasonal price fluctuations are connected to seasonal import restrictions. Malian production is marketed first, and when Cote d'Ivoirean rice arrives on the market, the price falls.

How well integrated? How well are price changes in one market communicated to other markets? Results show that marketing is quite efficient within Mali, following 1986-88 market liberalization, but it is segmented between Mali and neighboring countries. Price changes in Mali are poorly transmitted to neighboring countries, in large part because there is so little trade between them.

Constraints to trade. Transport costs are high due to the poor condition of roads and high tariffs on vehicles, fuel and spare parts. These costs are three to four times higher than transport costs in Asia. This is the binding constraint. In addition, high barriers have been erected to protect local producers. Sometimes these barriers are higher for regional imports than international markets, because some countries earn a cess on international rice imports. Mali does not even allow rice imports. Two years ago there was an acute shortage. Following that shortage, government reduced the import tariff from 46 percent to 10 percent.

Mali’s best strategy is to take advantage of seasonal rice comparative advantage. Also, the dearth of information sharing between countries should be addressed. Trade finance does not appear to be a large obstacle.

Abdoul Barry, *Impact of adjustment on agricultural competitiveness and regional trade in Sahelian West Africa*.

This study seeks to examine the effects of structural adjustment programs (SAPs) on comparative advantage and competitiveness in Sahelian West Africa. It also examines the extent to which SAPs have been implemented and what factors may be constraining regional trade. The decision was taken to concentrate on the post 1994 SAP, when devaluation took place.

During the study period, Mali’s comparative advantage for millet declined mainly because yields declined 1 percent per year for millet and other course grains. For rice, Mali's comparative advantage increased during the SAP in inland markets but worsened in coastal markets due to high transport costs. In addition to increased returns to rice production in Mali, there were also increased returns to horticultural products at the farmgate during the SAP. Livestock profitability increased in both Sahelian and coastal markets. Financial profitability was low for maize when family labor was valued at its opportunity cost (daily wage). For rice and livestock, profitability was higher.

A number of constraints to regional trade in West Africa were identified in the study:

- Institutional inefficiency - regional organizations such as ECOWAS are not working
- Lack of coordination among countries in their market information systems
- High transportation costs
- Abuse of law enforcement
- Differences in money transfer protocols between countries

In addition, several subsectoral constraints were identified:

- Volatile product prices, especially for cereals;
- Low supply response for livestock;
- High protective barriers for rice; and
- The late liberalization of domestic rice markets.

Aboulaye Diagne, Discussant

Is the rate of growth of production 2 percent (Malian statistics) or 3 percent (FAO)? This is a large spread. Regarding the estimated 1993 production/yield in Senegal, this seems very low. Is this typical for Senegal?

On the methodological side, there is an absence in the study of an analytical framework for comparing policies. What about the recent policies? Do they favor or hinder the development of exports for Malian rice? If the DRC for Mali exceeds unity and the value of DRCs among its neighbors, does this imply that Mali has a comparative advantage? What role does the value of the Guinean franc play in this? The author does not explain how he calculated financial profitability. What is the relationship between financial profitability and comparative advantage?

The work seems to show that Mali does not enjoy a comparative advantage, but it doesn't show that clearly.

Questions and comments from the floor

Q. Daniel Ramarokoto. What are the traditional export products from Uganda? How does comparative advantage go between Uganda and Kenya? Is the goal to put in place a macroeconomic policy that is more supportive of trade?

Q. The problem of tariff barriers is not mentioned. Is there such a problem?

Q. In Madagascar we estimate consumption at a rate of 120 kilograms per person per year. We have yields of 8-12 tons than on the research stations. What is the interest of the study in this case?

On the SAP study:

Q. For Mr. Opio. On the production side, how do fluctuations in rainfall affect prices and transborder shipment?

Q. The issue has been raised by a discussant as to the clientele for this work. What steps are being taken to ensure that policy makers are not just evaluating their own policies?

Q. Do projections of Malian rice production take account of new areas brought under cultivation?

Q. Is 1993 representative? Is there an error in the table? Senegal produces 200,000 tons per year.

Q. It is too strong to say that Mali does not have a comparative advantage. In fact it does have a comparative advantage in the frontier zones of Senegal and in Guinea. In regard to the calculation of profitability, it is the difference between the price of a kilo of rice and the value of factors of production and marketing margins between the production region and the market. The Agricultural Sector Adjustment Program was implemented to try to eliminate barriers. It did not, however, touch customs tariffs in Cote d'Ivoire and Mali. In Senegal, there were reforms.

Responses

Fred Opio. Who is the audience here? This is spelled out in the report, but you do not have a copy. They include government ministries of Agriculture, Trade, Planning, and Finance who for the most part realize that there are changing trends. They are not sure that their policies are right, and this is why they want to review them. The private sector will be involved in this process. In the last four to five years there has been considerable change toward freer trade. The Uganda Farmers Association has tried to advise farmers what crops to produce. In the past, maize and beans have been successfully marketed in Kenya and Rwanda.

The objective of the study is to ensure that changes in the trade environment are made over time. We have not yet been able to establish whether changes are occurring. Are trends changing, for example because Uganda is aggressively liberalizing? In May last year, Mr. Opio did a study of cereals in East and Southern Africa. Uganda was the least competitive producer. But late last year that changed. Why? Is it due to infrastructural changes? Is it due to reduced intermediate costs? Uganda seems to be reforming faster than its neighbors. It will take time to see how to take advantage of this.

Weather patterns influenced prices enormously. We are very seasonal producers. We have two rainy seasons.

C. Legal-Regulatory-Judicial Reforms and Governance

Chair: Ngure Mwaniki (M.A. Consulting)
Rapporteur: Arthur Goldsmith, (HIID)
Presenter: Patrick Meagher (IRIS)
Presenter: Haji Semboga (ESRF)

Patrick Meagher and Haji Semboja, *Business contracting practices in Tanzania.*

Theoretical perspectives. This study draws on the work of Douglas North and Oliver Williamson for its theoretical framework. This literature recognizes that markets exist everywhere, but that their efficiency is enhanced by supportive institutions. A favorable "contracting environment" allows markets to take on larger, more coordinated forms. Components of such a supportive environment include the rule of law (predictable and transparent procedures), market-augmenting rules, effective and low-cost enforcement of those rules, and good information networks. These factors encourage economic actors to enter into contracts, to take on anonymous business partners, specialize in what they produce, and take on greater risk. All of this contributes to more productive economic arrangements, which encourage, though they are not the only cause of, growth and greater well-being for the population.

Evidence to prove this broad hypothesis can be found in a variety of places: the amount of contract intensive money in a country (the ratio of non-currency money to the money supply, which presumably reflects the proportion of transactions in a country that rely on third-party enforcement); the extent of fixed capital formation (asset specific investments, which also reflect business confidence in the broad sense); technology transfers; and long-term supply relationships (i.e. transactions that are not immediate, and thus not self-enforcing).

Economic setting. Tanzania is a very low-income country but one in transition. It has initiated a large number of economic and political reforms in recent years. There has been a modest improvement in growth and some of the other macroeconomic indicators. The manufacturing sector, however, has had a poor performance. It is constrained by lack of capital and poor infrastructure, among other constraints. This sector was surveyed for this study, with a focus on the food, chemical, and wood subsectors.

A team of local researchers was used. They did some open-ended surveys, but the main phase of the study was a questionnaire of a random sample of companies. All were in urban areas. Most were privately-owned, mostly by local people. Almost all the firms had fewer than 100 employees. Most were profitable.

Findings. Most of these firms depended on a single supplier or a few suppliers. This dependence was mirrored on the output side with most having a single or few customers. This would appear to suggest a pattern of risk avoidance among the firms. How did they get to know these suppliers/customers? The contacts were made through business associations and personal contacts (though interestingly, not ethnicity). And most contacts were long term, on the order of 8 to 10 years on average. These factors suggest a large degree of informality in the business system and perhaps a lack of trust outside of well-known, face to face contacts.

The survey also found businesses want and demand advance payment or cash-on-delivery, more signs of a lack of trust. The time-lapses in these transactions was generally short, probably also due to mistrust and uncertainty. The firms did not use formal contracts extensively, nor did they resort much to legal counsel. The court system was rated very unfavorably over all.

To resolve disputes, the majority of firms resorted to bilateral bargaining. The lack of confidence in the legal system may be the result of a heritage of socialist jurisprudence, in which considerations of equity often outweigh the commercial merits of a case. Tanzania's courts tend nevertheless to be somewhat overwhelmed, due to a backlog of cases that cannot be settled out-of-court. No separate set of commercial courts exists, so plaintiffs must cope with generalist judges who are not equipped or trained to take care of business cases. Nor is there a system of arbitration or other forum for resolving business disputes. When combined with other deficiencies in commercial law, such as the lack of legal distinction between a corporation and an individual for certain purposes, the legal framework for business and commerce is not favorable.

Conclusion. This study offers some tentative support for the hypothesis advanced, namely that a poor legal environment for contracting constrains the development of efficient market relationships. No attempt is made here to separate these effects from others, such as a budget deficit, macroeconomic shock, and so forth. Future research should attempt to make such distinctions, and also should try to replicate this study in other African settings to see the degree to which the Tanzanian case is typical.

VI. Parallel Sessions: Thursday Afternoon, February 5

A. Tax Policy Reform

Chair: Diery Seck (IDRC)
Rapporteur: Eric Nelson (DAI)
Presenters: Pépé Andrianomanana (CEE) and Clive Gray (HIID)
Discussant: Arthur Goldsmith (HIID)
Presenters: Pépé Andrianomanana (CEE) and Jean Razafindravonona (EPM)
Discussant: Daniel Ramarokoto (STA)

Pépé Andrianomanana and Clive Gray, *Improving transparency in tax administration: The case of Madagascar*.

Pépé Andrianomanana. The starting point for this research is the premise that the transparency of fiscal administration needs to be reinforced. Greater transparency is expected to improve tax administration and fiscal performance. In Madagascar, fiscal performance has fallen from 14 percent in 1987 to 8-9 percent in the mid 1990s.

The hypothesis for the research effort is that tax administration needs to be reinforced simultaneously with the implementation of fiscal reforms. Improving tax administration requires improving the transparency of the tax system. If all of this is successful, increased tax receipts should be the result.

The research is currently in its second and final phase.

According to recent studies, weak fiscal administration is a principal factor in poor fiscal performance. This is manifested by an inability to cover all those subject to tax, control declarations of taxpayers, address under-estimates, and punish cheaters. These problems are exacerbated by exonerations and the history of earlier fiscal regimes.

The study calculated tax evasion by tax: direct taxes (IBS, IGRNS), indirect taxes (VAT, transactions tax TST), and taxes on foreign trade (import tax DTI, export tax DTE). The theoretical yield was calculated by sector and compared to actual receipts to calculate evasion. These estimates showed that 37 percent of VAT and about 94 percent of IGRNS (SME profits tax) was being paid. Vanilla exports paid little very little duty in 1994.

Real estate taxes formed a separate part of the study and were the subject of a small survey. Important evasions included: moral hazard in the system of self-declaration which reduces rental value, and inability of tax authorities to supervise and follow those who do not declare. Rental income was estimated to be under-declared by 50 percent.

Regarding fiscal exonerations, an opinion survey showed taxpayers are uninformed on tax laws. Only 50 percent have access to the official journal, and there is no source for interpretation of texts. Offices are too isolated from the people and there is so little publicity on sanctions that people think that cheaters are not fined. The perception is widespread that only the honest pay.

Clive Gray. The broader *Tax policy reform* study includes Tanzania but the project there is delayed. Another output of this study is a discussion paper on *U.S. practice in estimating and publicizing tax evasion.* The United States has a statistical survey for determining evasion and this shows a 13 percent gap on personal and corporate taxes. There is no U.S. data on indirect taxes since so those receipts are so small that evasion doesn't affect total compliance. In the United States, more than 2,000 persons were sent to prison in one year. This shows how governments can reduce evasion, through sanction and warning taxpayers.

Arthur Goldsmith, Discussant

The discussant reacted to the presentation by proposing that the form of taxation is important for the legitimacy of the government. Gray's U.S. income tax is a special case, since VAT and duties are unimportant, unlike the rest of the world. Furthermore, taxes as a share of GDP are very low. These factors are related. The political advantage of the U.S. system is garnered through its apparent progressiveness. The disadvantages of the system are that exceptions are available to those with access (loopholes, and other reductions are "sold" to political supporters); and visibility, seen at each transaction, motivates pressure for tax reduction, even anti-tax movements and reactions against the IRS. These set a political limit on tax rates. The principal lesson from the United States for Africa is the powerful role of publicity and humiliation in ensuring compliance.

Pépé Andrianomanana and Jean Razafindravonona, *Tax policy in Sub Saharan Africa: The role of excise taxes*.

Jean Razafindravonona. This study examined taxes on petrol and excises on alcohol and cigarettes in Madagascar with the question in mind What is the response of excise taxes to GDP growth? In addition, the study looked at the external effect of excise taxes on the economy of Madagascar. Tax buoyancy is positive and near one in nominal terms, and gasoline tax has a buoyancy of two, but all are negative in real terms.

The elasticity of the taxes examined in the study were found to be low, near zero. The tax on Petroleum Products (TOPP) was among the most stable and elastic taxes in the 1990s. This tax rose during the study period. This was seen to be related to increased demand for road maintenance following growth in road use. This shows a suitable matching of tax assessments and use of the public goods that are purchased with tax revenues. Diesel is more commonly used than gasoline and this follows tax policy. This tax is appropriate from an environmental point of view. There is a negative elasticity in the TOPP for charcoal use, so deforestation is not linked to the TOPP. Considering income distribution, the study looked at the fuel tax to assess what portion of this was being used for public transport and found that, due to other operating costs, the share of benefit was small: 0.089 percent of CPI for busses, 0.26 percent for trucks.

In terms of excise taxes, elasticities were negative for alcohol, and positive for cigarettes.

Daniel Ramarokoto, Discussant

Excise taxes are linked to more or less determined objectives. The IMF has tried to calculate losses on the TOPP, but the TOPP provides only 11 percent of fiscal receipts so an increase of 10 percent only raises fiscal receipts by 1 percent. Increases in this tax will, however, have an immediate and direct effect on consumer prices. The TOPP is a specific tax so devaluation erodes it. The more you force an increase in tax size the more you risk harming the economy.

Questions and comments from the floor

Q. Why is there no tax on agricultural inputs? In regard to taxes on small businesses, are they not exempt in order to provide incentive for business investment?

Q. One problem related to criminalizing taxes is its impact on rural taxpayers. Their problem is not a lack of means to pay, but an absence of reason/motives to do so. This populace never encounters the state, they have no electricity, they walk 10 kilometers to get water, and there are no roads. Around them they see civil servants who benefit from taxes.

Q. Revenue projections are often way off, so how can you calculate degree of evasion from projections? This is not like the United States. On tax exemption, Malawi has ministerial discretion to allow clients to not pay taxes. What does Madagascar do?

Responses

Agricultural input taxes are import taxes (DTI), exonerated from VAT. Table figures are aggregates for all DTI. Data were not available for specific agricultural inputs. In regard to exonerations, 1993-94 inputs were exonerated from VAT. Most activities take place under VAT. In regard to criminalization, he doesn't believe that government has the power to get the informal sector, as they are isolated and carry high unit costs in enforcement. It is for those reasons that the 50-90 percent of the non-compliants represented by that population are not pursued by the state.

Theoretical receipts are based on calculating theoretical base, so evasion is residual. Discretionary practices on tax collection and lack of publicity is an important determinant of tax evasion.

B. Promoting an Environment for Private Sector Activity

Chair: Ngure Mwaniki (M.A. Consulting)
Rapporteur: Patrick Meagher (IRIS)
Presenters: Polycarp Musinguzi (Bank of Uganda) and Marios Obwana (EPRC)
Discussant: Andrew Bvumbe (Reserve Bank of Zimbabwe)
Presenter: Germina Ssemogerere (Makerere University)

The Chairman opened the session with comments regarding the poor performance throughout Sub Saharan Africa of governments in establishing policy and regulatory environments that promote private sector activity. In particular, Mr. Mwaniki noted the lack of trade agreements among the countries of SSA. While such institutions as COMESA and SADC exist, participation in trade integration is very limited. At the same time financial markets are becoming increasingly globalized and SSA is missing the boat. He expressed his hope that the papers presented here would address these issues in a form that provided substantive means for improving this performance.

Polycarp Musinguzi and Marios Obwana,   *Monetary and exchange rate policy in Uganda*.

Mr. Musinguzi began his presentation with the enumeration of the four principal issues addressed by his research. These include:

- How have monetary shocks effected the real exchange rate?
- What is the long-run relationship between nominal money supply and the nominal exchange rate?
- Has monetary policy in Uganda been consistent with the objective of achieving international competitiveness?
- Has the official exchange rate been driven by the bureau exchange rate?

The prime objective of the Ugandan monetary authorities is to control inflation. This is being done through tighter control on public borrowing; allowing market forces to set interest rates; open market operations; and tax policy reforms. While these measures have reduced inflationary pressures, aid inflows are now exerting upward pressure on the value of the Ugandan shilling.

Since 1986-7, Uganda has enjoyed real growth averaging about 7 percent, per annum. However, in 1996-7, growth dropped to 5 percent due to drought and other factors. Ten years ago, inflation was around 250 percent. Now it is approaching 3 percent. Foreign exchange reserves equal about 4.5 months of imports.

The study sought to improve understanding of the linkages between macro policy issues including monetary, real, fiscal, and trading sector linkages. Data sources included the Bank of Uganda, the Ministry of Finance, the Ministry of Planning, EPRC, the Uganda Revenue Authority, and the IMF and other international donors. Second and third stage least squares equations (non-linear) were estimated with these data. Institutional aspects were captured through interviews with stakeholders and government officials.

The real effective exchange rate equation showed no linkage between capital inflows and an appreciation of the RER. The export equation had some problems with serial correlation. The imports equation had no significant coefficients. The government expenditure equation showed linkages between government spending and donor support, industrial production and lagged tax revenues.

The authors conclude that the monetary authorities should better balance the need for a competitive exchange rate and the objective of stable domestic prices. They find some evidence that exchange rate appreciation has hurt Ugandan exporters. They are confident, however, that Uganda can make the transition from adjustment and stabilization to sustainable, export-led development if government:

- lives within the equilibrium RER path and flexible exchange rate band;
- avoids lowering reserve requirements on foreign exchange liabilities or lowers them very slowly;
- strengthens, deepens, and broadens the financial system;
- secures fiscal adjustment;
- removes remaining capital controls and enters new a era of financial sector liberalization;
- avoids ineffective sterilization;
- establishes better trade policies and appropriate macro policies and institutions; and
- works for regional policy harmonization.

Andrew Bvumbe, Discussant

Uganda provides an example of yesterday's discussion of sequencing policy reform. Moreover, the study presented gives some insight into the effect of financial sector liberalization on both efficiency of the financial sector and in terms of other macro policy changes. If we look at the shocks induced by foreign exchange inflows, we see that there is no way to soak up excess liquidity. This had much to do with the absence of measures to ensure that financial markets were working efficiently.

The paper reveals too many targets for the monetary authorities. This could distort the monetary programming process. It is better to target a single variable such as inflation, exchange rate, or level of foreign reserves. Also, is the Ugandan Central Bank independent? Does it have the authority to pursue a single goal such as price stability?

Responses

The Ugandan Central Bank was granted independence in 1993. In practice, it hammers out monetary policies after discussions with the Ministry of Finance. This linkage works because of the close connections between fiscal and monetary policy.

Both the formal and informal financial sectors are strong in Uganda. Because the data do not cover the informal sector, some of the linkages in the model are weak. An example of bias here is that tax evasion mainly occurs among the self-employed. Formal employees/firms have stringent rules, and pay tax.

Questions and comments from the floor

Q. The relationship between the two models is not clear. Policy conclusions derive from the macro model, but some issues addressed were not included in the model. The output of econometric model is not entirely consistent with final conclusions. The connection not clear.

R. We left out some steps due to lack of time.

Q. How did Uganda get its inflation rate so low?

R. There is political will to keep it low, plus stability.

Germina Ssemogerere, *Competitiveness of the industrial sector in Uganda and Kenya***.**

This study looks at the growth in the Ugandan economy over the period 1987-96 and at the performance of the manufacturing sector vis-a-vis competitiveness and growth. It begs the question What is the source of Uganda's growth? and Why, in the process, have Uganda's manufactured products not become more competitive?

Ms. Ssemogerere identifies the sources of Uganda's economic strength as:

- Private remittances
- Return of confiscated properties to Asians, who have come back
- Official foreign exchange regime has entailed a subsidy in that rates were set below market to keep imported inputs cheap
- Capacity utilization re., old plant, equipment, plantations, small farms
- Marketing efficiency: CMB, PMB, LMB marketing boards were abolished
- Foreign exchange bureaus -- liberalization in foreign exchange markets

On the other hand, she saw indicators of lack of competitiveness on the export side, including sluggish raw material exports; manufactured exports to neighboring countries growing more slowly than they should be; and some exports that do not pass export requirements (EU health restrictions, inadequate cold storage facilities.) On the import side, there is evidence that imports are increasing market share in clothing, shoes, bicycles, spare parts, etc.

What are the competitiveness factors?

- Long term competitiveness requires greater reliance on skilled labor.
- Uganda has potential for growth in resource-intensive industries and in industries such as agro-processing, where value is added. Resource markets include non-metallic minerals and forest products.
- Ugandan producers must improve their delivery schedules and other marketing aspects.

Issues that will tend to impede Uganda's progress toward competitiveness include:

- The high cost of finance: interest rates of 20-28 percent undermines capital investment for new plants and equipment.
- Infrastructure, including electricity, roads, and rail (especially corruption in rail system).
- Taxation: Import tax raises import costs and leads to anti-export bias.
- Investment code: tax holidays, duty exemptions on plant and equipment, raw materials provide support for large-scale FDI, but does not encourage local investment or R&D or training.

Ms. Ssemogerere noted that research had been complicated by data collection and the fact that companies keep various sets of books, which makes it hard to do research.

Margaret McMillan, Discussant

The draft paper was very good but did not emphasize enough how policies affect competitiveness. There is need for a methodology section in paper. Some of the discussion should focus on how to remove market failures and how to have impact on competitiveness. It should also account for the impact of low education levels in Uganda. The paper would benefit from a review of how others have measured competitiveness.

Questions and comments from the floor

Q. A USAID-funded study on competitiveness by Kevin Murphy was recently completed. What is the potential for some of the problem areas, such as fish exports rejection? Uganda is over-banked, and when a bank tried to introduce competition by expanding hours, the Central Bank clamped down. In regard to R&D, if companies are working with outdated equipment, firms won’t be spending on R&D. They aren’t even spending on new equipment. Where is Uganda’s comparative advantage in R&D?

Q. Should look at geographic location as a competitive issue. Uganda is landlocked. This seems an import issue in regard to import of capital goods. There are elements of competition between Kenya and Uganda. How might the two countries rationalize trade? To what extent are their strengths complementary?

Q. Note that there are other factors affecting competition such as tax-evasion and customs fraud. These suggest larger governance problems. In regard to infrastructure, not just roads, but also telecoms and Internet, how are these doing in Uganda?

R. The comment on R&D is a concern. One shouldn’t industrialize only through imitation. Also foreigners get incentives/concessions, etc. The tax evasion points are correct. There have been recent scandals. Transport needs to be addressed. It is not a good idea to tax petrol because this will raise transport costs. It is important to note that distortions don’t come only from government interference.

C. Labor Markets, Employment, and Productivity in South Africa

Chair: Rashad Cassim (TIPS)
Rapporteur: Robert Davies (Univ. of Zimbabwe)
Presenters: Fuad Cassim (University of Witwatersrand) and Dirck Stryker (AIRD)
Discussant: Donald Mead
Presenters: Lynn Salinger (AIRD), Haroon Bhorat (UCT), Malcolm Keswell (University of Natal)
Discussant: Keryn House (DTI)

Fuad Cassim and Dirck Stryker, *Increasing labor demand and productivity in South Africa*.

This presentation was based on preliminary research and that the findings are tentative. The main problem in South Africa, and the focus of the research, is that the key employment generating sector, manufacturing, has recently been shedding labor. Although output and employment moved together until 1994, there appears to have been a structural break at that time, with output rising while employment fell. There are a number of possible reasons for this. It could be rising productivity, which is obviously going up, but this is not the type of productivity growth that is needed to solve unemployment. It might also be the result of the liberalization that occurred around this same time. However, there has also been devaluation of the rand and the question is: Why has this not led to expanding demand for labor? There may also be data problems. In particular, it is known that the data do not include small firms which may have been expanding. The authors intend to examine these explanations.

Another problem of interest is that wages have been rising faster than inflation. This suggests that there is an "insider-outsider" problem. Those with jobs are doing well while those without have little prospect of finding work.

The authors also pointed out that there is employment growth in some sectors, particularly in tourism and financial services, but that this has not been sufficient to absorb the unemployment from other sectors. Finally, in this introduction, the authors pointed out that the available data do not capture informal employment growth which has been less significant.

In their empirical work, the authors have thought about three different perspectives. Firstly, from an employment and structure of production approach, they had intended using time series and input/output data, but they discovered that this had been extensively analyzed already. There was a similar problem using available labor survey data. However, they had recently acquired a set of data from the ILO based on a firm-level survey. Although they had not had a chance to analyze this properly, a quick set of estimations suggested that there were some interesting features. Probably the most interesting one was that there was a strong positive relation between firm-level training expenditure and expanding employment. The authors plan to examine this data more rigorously and in more detail.

Don Mead, Discussant

The main question raised by the discussant related to the "insider-outsider" distinction raised by the authors. Mr. Mead said it was important to be clear about who was "outside". Is there a distinction between those employed in the modern sector and those employed elsewhere? He wanted to know what is included in the data set.

Questions and comments from the floor

A participant asked how the authors attacked the question of the brain drain, which was significant enough to cause a net loss of the labor force. He also wanted to know if the authors were allowing for the impact of GER, since it could distort actual patterns.

Response

The authors said that their main focus is on formal sector employment, which is what their data set is about. They could not do their own survey work. They had used the "insider outsider" terminology to describe the situation, but would be explaining the precise problem in more detail. Finally they recognized that they would have to look at how GER affects their research findings.

Lynn Salinger, Haroon Bhorat, Diane P. Flaherty and Malcolm Keswell, *Promoting the competitiveness of textiles and clothing manufacture in South Africa.*

The labor market in South Africa can be divided into those workers covered by industrial councils, those covered by wage boards, and others. A recent report has recommended that wage boards be extended to cover all firms, that piece work wages be abolished, and that exemptions for SMEs be ended. This resuscitation of wage boards marks a highly interventionist approach.

The data show a large employment loss, particularly among Asian workers. This could be a result of the recent migration of firms out of cities and into the rural areas. The MFA has provided help to South Africa because its quota allocations, but the investment by Taiwanese firms in rural areas is an unanticipated response of firms to circumvent labor regulations. The DTI reform agenda was targeted on removing tariffs and improving competitiveness of South African manufactures.

However, and significantly, estimates of long and short-run price elasticities provide evidence that exports from the South African textile and clothing industries are largely residual after domestic consumption. The tendency seems to be for firms to market the majority of their export locally and to then export what remains.

The survey in the Western Cape showed that firms regarded "market inflexibility" problems as being related to short-term employment issues rather than wages. This had to do with temporal variability in demand for labor and restrictions against temporary employment. Firms also complained about absenteeism. Some firms were experimenting with imaginative incentive schemes to cope with this problem. Firms also showed interest in training workers.

Analyzing financial and economic aspects of firms, the authors found that financial costs were less than domestic output prices, giving the industry net financial profits. However, economic costs tended to be higher than border prices, making net economic profits negative for exports. This may be a result of high nominal and effective protection rates.

The surveys showed that the problem of instability is significant. Instability derives from many sources. Examples included changes in tariff rates and the large number of tariffs imposed. Another factor was the illegal exportation of new clothing which made forecasts of domestic supply and demand problematic.

There was an apparent conflict between the clothing manufacturers and the textile mills. The former regarded the latter as old fashioned and unreliable.

There appeared to be two types of firms when it came to attitudes toward competitiveness. One group saw competitiveness as being related to cost cutting and labor discipline. Firms in this group were often pessimistic about the future. The other group saw competitiveness as promoting flexibility in labor and organizational practices. Firms in this group tend to be growing.

In conclusion, the authors emphasized the importance of flexibility and the use of alternative labor practices. It is also important to delink pipelines between clothing and textile manufacturers. They produce different goods and should be encouraged to compete openly. Finally, there is a role for cooperation between government and the private sector in the areas of technical research and development, managerial and work force training, and export promotion.

Keryn House, Discussant

The discussant began by noting the importance of this research. She then addressed several of the points that the authors had made. Although some exports are residual, she noted that some firms are actively seeking export markets. The question is how to support this trend. She agreed on the importance of improving management practices. In particular, she saw a need to get managers to focus on the wider process of making and selling clothing. The negative attitude toward investment needs to be tackled. There needs to be better communication from government of the positive prospects for the industry.

Although firms claimed tariff policy caused instability, all shifts in tariffs were pre-announced and the shift in tariff rates was toward reduction. It is true that there are a large number of tariff lines, but this a function of the large number of product lines.

It was pointed out that many countries were moving up-market in the face of wage competition from low-income countries. But it could be asked: How is it possible for all countries to move in the same direction at the same time?

Questions and comments from the floor

Q. What is the market impact of the restrictions on imports of second-hand clothing?

Q. Are the firms that are beginning to take more positive approaches toward competitiveness the same ones that have experimented with industrial clusters? Is there a race/ethnic aspect to the set of firms practicing task-sharing?

C. It was noted that the response of some firms to the current shake-out in South Africa was similar to the response of successful firms in Mauritius. There, the more innovative firms welcomed international competition as a positive force.

Q. Are those foreign firms that are locating in the rural areas more or less prone to bad labor relations? What about the role of factory shops? Is the informal sector quite important in this industry?

Responses

The authors did not know if task-sharing arrangements were correlated with ethnicity. There are, however, some indications that the opportunistic firms that were locating in rural areas were suffering bad labor relations. Factory shops were not significant.

VII. Plenary: Creating a Network of Policy Research in Africa

Chair: Richard Harber (USAID/South Africa)
Rapporteur: Lynn Salinger (AIRD)
Panel: Diery Seck (IDRC)
Rashad Cassim (TIPS)
Abdoulaye Diagne (CREA)
Fred Opio (EPRC)
Dirck Stryker (AIRD)
Clive Gray (HIID)

Panel Discussion

Diery Seck spoke of the need not only to support stand-alone research, but to create networks of policy oriented research institutions. IDRC believes in networks for sharing information among members of the scientific community. AERC and the *Reseau de Recherche sur les Politiques Industrielles* are two African examples of these. However, these have focused on networks of individual researchers. The time has come to go a little further, toward a network of research institutions. Last July 1997, USAID, IDRC, and CIDA created SISERA. This secretariat provides assistance to institutions carrying out policy-oriented research, and has been very successful thus far. The existence of SISERA parallels discussions which have been held with EAGER and USAID about the need for African research centers to be more in control of the process of doing research. This shift is welcome. This new network consists at the moment of a small number of high quality institutions. Seeking complementary not competing areas of activity, the group is still looking for the right working modalities.

Rashad Cassim believes it is important to point out that there are two kinds of research institutions. One does research in-house, while the other employs a clearinghouse concept. TIPS and AERC are examples of the latter. The clearinghouse can play a networking role, too. We should also distinguish the content of research being produced. AERC is an academic network, building top quality, more theoretical economists. It uses peer reviews and provides interaction with international experts on the leading frontiers of their fields. Applied research is more complex. One needs to ensure that the content of applied research is both academically credible and applicable to the concerns of policy makers. There is a need to strengthen linkages among those who work in government, and also to talk about dissemination of research to policy makers. What is the best way of ensuring both are brought together? We need a common language. There is a pool of very good economists on the African continent. How can we link them with the policy making community?

Abdoulaye Diagne pointed out there are already several African networks which work fairly well. We need to understand how they operate, and whether there are lacunae among these which this new network would fill in. It is true that there is currently a lack of direct links between these regional networks and the national institutions. In order to contribute to capacity creation, it is critical that this pan-African network focus on local issues.

Fred Opio offered a stages approach to the analysis of network building in Africa. First, this networking occurs at the level of individual researchers who ask: Is there an established group somewhere to which I can belong in order to do policy research? Individuals need to identify or create an institution doing this kind of work. Second, there is a need to organize such researchers at the national level. Once these exist, then you can talk about networking, again at national level among institutions doing policy research. These institutions can thus exchange views and even share in collaborative research. Finally, institutions can also be linked in a network at the regional or intercontinental level, with resources and facilities allocated. Use of the Internet will help in this process. Fundamental to networking is an exchange of ideas. Opio supports the idea of networks, which will help us to become known and get our information out to the right people. We should do more workshops to network at the continental level.

Dirck Stryker added a few comments. The idea of networks among research centers as seen from the perspective of EAGER project, itself oriented toward the policy research nexus, is that there are different ways to accomplish this. One can do independent research and then convene workshops to share results. EAGER has tried something a little different. It builds research directly into the policy formulation process. Results of such research, eagerly anticipated before the research is even launched, are used before the research is even done. The EAGER project has achieved a certain measure of success here. This model is working. Now the linkages between research centers and policy makers need building for sustainability. Note that this is not the same as a short term consultancy where a specific answer is needed. We're talking about longer term research here. For example, the global trade model is a major undertaking and it will take years for its use and impact to be spread across Africa. This is a tool that can be shared among a variety of countries to evaluate any given number of policy tools. One set of results of the model was demonstrated today, with quantitative direct implications for the South Africa/ SACU/ European Union dialogue. This is the kind of thing we're emphasizing. Another aspect we have emphasized in this work is inclusion of the private sector into the research agenda. Researchers and policy makers alone are insufficient.

Clive Gray stressed that his institution is very anxious to participate in the kind of exercise being described here. SISERA is an excellent permanent framework for the network initiated by EAGER. One question he poses was with regard to its membership. While a list of proposed members of the network has been identified, what are the criteria for new membership? He noted that the institutional representation from the EAGER project does not perfectly overlap with SISERA's proposed membership. In part this is due to the fact that EAGER's country coverage is constrained by USAID involvement. However, he pointed out that there are seven or eight institutes whose staff are participating in EAGER studies, but whose research centers are not on the SISERA list. Is SISERA membership open? What membership conditions can be set up? What is anticipated regarding a newsletter and conferences, about fee based membership? Can foreign institutes be members? Or participate as observers?

Questions and comments from the floor

David Camara noted that his organization welcomes the establishment of such a network. The ECA has been doing research for fifty years, but it is never used. The ECA is now pursuing a more aggressive strategy to see that new uses are found for ECA research. An ECA web page will link these national centers. The ECA would like to be the centralized disseminate of research results in Africa. It has also developed a large database, and would like to coordinate use of this data.

Nora Hill. A question for Rashad: You talked about policy makers getting together with researchers. Does this duplicate or complement the capacity building program?

Ngure Mwaniki. Many people are working in Africa as consultants, either as individuals or members of small firms. They contribute to policy and economic results, too. They are a substantial human resource on the continent. We should either encourage them to network by joining institutions or by working directly with development organizations. The World Bank's African Capacity Building Foundation effort hasn't gone very far in this regard.

David Camara. I'd just like to complete Mr. Mwaniki's thoughts. We're expecting in the next three years to train researchers in GTAP and other modeling systems. We will have a seminar soon in Cameroon to show how quantitative instruments are useful. We will do a large training of researchers in GTAP.

Rob Wieland. How do foreigners find out how to disseminate books to African policy research institutes? We need to be able to find you on the WorldwideWeb. How will you fund this network?

Diery Seck. We decided to limit the number of partner institutions to those who have a demonstrated capacity. We identified ten across SSA and are still open to letting in a few more. We want a working group that can meet regularly and make a difference. Five of these institutions are in EAGER (CEPA, ESRF, EPRC, DPRU, CREA/Senegal). There are two elements of membership. An institution can become a member later. SISERA has a board which decides who becomes a member. Seed grants will be available from SISERA, to partner and non-partner institutions. Newsletters, conferences, etc are already planned. Next month in Accra we will have the first partner meeting. As for outsider participation, yes, it has to be done. Research centers in Africa don't have same level of access or expertise and can improve upon skills and access to policy makers.

Rashad Cassim. Capacity building process takes place in a number of ways. Bringing researchers and policy makers together is not capacity building. If economists produce all these complex models, then government can't understand them. We need courses so that researchers can tailor their product to needs of policy makers.

Diery Seck. In response to the funding question. This is a delicate question. We know that a lot of donors have shown considerable reluctance regarding institutional support recently, i.e. they would prefer to fund results. One aspect of SISERA is to help enhance the managerial capacity of research centers. A lot of donors are sensitive to this. Once centers have good managerial capacity, then donors won't be so reluctant to fund them. Lots of donors are out there supporting AERC and other networks. The problem is with some bilateral donors, many of which see their support as an extension of their foreign policy. What their aid buys must be visible. Some donors are lukewarm about behind the scenes support.

Eric Nelson. When we start discussing costs, let's recognize that this is expensive, this EAGER stuff. What is the sustainability of the network if it is dependent on donor funding? There is a finance network, via Ohio State, which maintains a server and broadcasts messages and documents internationally, and which thereby maintains a network of a sort. There are new low cost possibilities for sustaining networks.

Ed Bbenkele. Question for Messrs. Grey and Stryker. We are here as EAGER, but what about the regional organizations such as COMESA and SADC, where are they? Taking SADC, they established the SADC university trust, a network of academic researchers and consultants to provide results to governments. Why don't we start at a higher institutional level? Here we are as EAGER, let's interact with broader organizations. Where was SADC in Tanzania/EAGER? Where is the SADC desk officer at this conference?

Tom McEwan. I worry when I hear about networks. The concept has so many different meanings. Evidence is firm that those that succeed are the ones with informal linkages, building up from small clusters. You need to consider what the EU has done for academic exchange in Europe. Those that are still around are the ones that emerged organically.

Clive Gray. With respect to Ed Bbenkele's connection, shouldn't SISERA have a connection to SADC and other such regional organizations?

Dirck Stryker. The EAGER project basically started working at national level in order to get into the grassroots of policy making, rather than going through ECA/ECOWAS/UEMOA/etc. I think it's important we take those into consideration, and we should expand this. I just went to the ECA before coming to South Africa to touch base with them. Ultimately, it is important to link up with regional organizations such as SADC and COMESA. But let's remember that EAGER is a project with a certain finite time horizon. It will end in September 1999. Regional organizational ties should be thought about in the context of broader ongoing efforts. EAGER shouldn't try for too much in the way of new initiatives. You are right, we do need to involve the regional organizations, we did invite a lot of people here, but many didn't show up.

Diery Seck. Mr. Mwaniki’s question regarding consultants never got answered. Regarding consultants, membership in local institutions, membership is on an individual basis. Networks of institutions is another thing. The institution needs a synergy between research and training and research and policy making. Now individuals are not eligible for SISERA.

Fred Opio. Consultants are potential researchers. They all focus on new jobs within the country, from government or something. They are not known well enough to be approached by international agencies. It is hard to sell such consultants on the international market for research. I would encourage individuals to network at a national level with institutions that are likely to work with consultancies.

Network of policy research in Africa. We all agree that the aim is to share research results, but my problem is that there are countries that will need these results (like Ghana), where the researchers are not even able to visit.

Polycarp Musinguzi. We have a plethora of research departments dealing in Africa. What is this network supposed to achieve? Could it bring in the multilaterals and influence their thinking?

Chairman Rick Harber. To summarize: there have been many good ideas put forward. The idea that a formal network complete with large-scale administrative support and conferencing is an expensive approach is important in terms of sustainability. Eric Nelson's idea regarding cyber networks is noteworthy as is the idea that sustainability hinges on the degree of organic participation and benefit to members. There were a variety of issues raised concerning participation and inclusion: what are the selection mechanisms, how is it funded, what donors, what modalities, what mission of network, what leadership. A variety of people will undoubtedly be thinking more about this over the next month. Ideas should be sent to Diery Seck. A participant’s list is coming shortly.

VIII. Parallel Sessions, 9:00 Friday Morning, February 6

A. Contribution of Business Linkages to the Growth of Productive Employment Among Small Enterprises in South Africa

Chair: Tom McEwan (UNP, PMB, South Africa)
Rapporteur: Dunstan S. C. Spencer (DS & A)
Presenters: Ed Bbenkele (University of Natal), Francis Anim (University of South Africa), and Donald Mead (Michigan State University)
Discussant: Bala Rajaratnam (Ntsika, SA)

Don Mead, *The contribution of business linkages to the growth of productive employment among SMMEs in South Africa: approaches and principal findings to date.*

Mr. Mead introduced the paper with a brief history of the project. The Dutch government had concluded after a review in the late 1980's that linkage projects would not be supported. After a review in 1993, USAID reached a similar conclusion. Mead and others feel that the conclusions are too strong, hence the project aims to explore the conditions under which linkage projects could be expected to function best. Six researchers in two universities are involved in the project.

Ed Bbenkele presented a section of the paper focusing on the traditional medicines sector. He indicated that 450-790 tons of tubers, barks, etc., pass through the traditional medicines marketing sector each year. The gatherers have many customers including herbalists, pharmaceutical companies, and consumers. Murthi, the traditional medicines, are mixtures of herbs. He showed a video of participants in the market chain in which women are fully represented and the products on sale consist of raw products as well as semi-finished, dried products.

Pharmaceutical companies in traditional medicine are mainly family-owned with highly trained pharmacists as required by law. They produce a wide range of unregistered (traditional) medicines and some registered medicines and products.

Three types of linkages are examined: gatherers export to Europe, gatherers supply pharmaceutical manufacturers, gatherers become growers of roots and herbs. All three linkages are important, but the prospects for expanding the export market appear to be greatest since such activity is not likely to impact on the large manufacturers. Bbenkele also believes that the prospects for gatherers growing their own produce is very great.

Owen Skae presented a discussion of linkages in the Durban and Richards Bay area. Eleven corporations and two SMMEs have been interviewed to date. Corporations have entered into linkage activities mainly to support black enterprises, however they source mainly non-core services such as cleaning services. Building linkages will take much time, and will only occur if top management is committed. This shift in production will go unnoticed unless data on variables for measuring linkages are available. The later are only being developed now. The establishment of regional consultative fora will help firms that are trying to strengthen linkages.

Francis Okai presented a discussion on promoting the growth of micro and small enterprises in the northern province. He pointed out that the enterprises are mainly owned by blacks. The objective of his research is to see how linkages with white-owned large firms could be improved. About 63 enterprises have been interviewed to date. Buyers are mainly small firms with employment ranging from three to eighty-eight. They are relatively young businesses ranging in age from one to seven years.

Suppliers are also relatively small, usually with one to three workers, although the largest has over 40 workers. Only a third have had primary education, although surprisingly virtually all reported that they have had some type of management training. A very small proportion of their output goes to the large buyers.

Donald Mead, in giving an overview of the findings to date, indicated that there appears to be widespread interest in linkages in South Africa. Although from a developmental view not all linkages are good, linkages can contribute to the development of suppliers enterprises. Experience with development of small enterprises has shown that one of their major constraints is development of markets. Forging linkages with large buyers is often a way of overcoming the problem.

Bala Rajaratnam, Discussant

The discussant pointed out that linkages are important for economic development. They can help kick-start micro enterprises by providing skills, markets etc. He felt that the geographical coverage of the project is adequate.

In the traditional medicines study, the sustainability of the enterprises and linkages should be given more emphasis. However, it is would not be possible to look at the sector monolithically. Rather the issues may need to be addressed case by case.

All the studies should pay attention to the capital investment problems of fostering linkages. They should also pay more attention to the problems of female run enterprises, as well as the role that business associations and NGO’s can play.

Questions and comments from the floor

Q. Gatherers of products for traditional medicines may be going against the environmental lobby. If they become growers won't they run into the land availability problem?

R. Bbenkele feels that not much land is needed and production practices are simple. Government may intervene by providing land for small backyard gardens. Converting gatherers to growers may in fact reduce the adverse environmental impact.

C. It may be better for the government to use the carrot rather than the stick method to encourage linkages, by giving tax breaks, etc.

R. Skae noted that there is an on-going conflict between proponents of directive legislation and those who propose incentive policies which the research project would examine later.

C. It is worth looking into the role financial institutions can play in stimulating increases in business linkages.

C. The experience with out-sourcing of intermediate goods and other supplies particularly in the clothing industry should be studied. The University of Natal is very interested in the issue of out-sourcing and is studying it in a number of related projects.

R. The lax nature of registration of traditional medicines may be encouraging the sale of products which do not do what they are touted to do. Bbenkele expects to investigate this issue further.

The project also expects to examine the role that business associations, NGOs, etc. could play in fostering linkages

B. Reforming Financial Markets in Sub Saharan Africa

Chair: Andrew Bvumbe (University of Zimbabwe)
Rapporteur: Polycarp Musinguzi (Bank of Uganda)
Presenter: Sam Ziorklui (Howard University)
Presenter: Fritz Gockel (University of Ghana)
Discussant: Eric Nelson (DAI)

Fritz Gockel, *The impact of financial deepening on bank efficiency*.

Ghana is one of the SSA countries that has been carrying out serious financial sector reform. In the past, Ghana has had a poorly functioning financial system. Banks were high cost, did little savings mobilization, at negative real interest rates, and had high loan losses. As a starting place, the Financial Sector Adjustment Program (FINSAP) in Ghana has aimed at increasing the efficiency of savings mobilization. It also has components that deal with prudential regulation and capital market development. The second phase of the FINSAP aimed to improve linkages between the formal and informal financial sectors.

As part of the FINSAP, a new banking law was passed in Ghana and it raised capital adequacy requirements from 6 percent to 10 percent assets. While the banking sector in Ghana was primarily comprised of state-owned institutions before the FINSAP, now there are seven privately-owned institutions operating in the sector. These offer new services such as merchant banking or stockbrokerage, and offer higher deposit interest rates.

There are problems:

- The sector is still marked by high lending margins.
- The payments and clearing system is still under developed with checks drawn in Accra against accounts held in banks in Accra taking 3 days but checks drawn on up-country banks taking several weeks.
- There is still considerable market segmentation.
- The sector is contracting, as older banks are closing smaller and rural branches and focusing their efforts on the three major urban areas; access to banking services is thus more limited than it was before the reform..
- Financial deepening, measured as M2 to GDP is stuck at about 18 percent.
- Lending rates are high relative to savings rates which are actually negative in real terms.
- The economy is showing signs of dollarization, to the extent that the central bank must include dollar deposits in one of its measures of money supply..
- There is a lack of confidence in the banking system.
- Government attempts to reduce inflation have not succeeded to date (target is 18 percent, actual is 70 percent).
- The banking system as a whole is not attracting significant increases in savings.

However, different banks are performing differently. The new "magic banks" have high spreads and offer positive rates of return on deposits, while state-owned banks have not responded. New banks are attracting longer-term deposits. It is the new banks which are largely investing their deposits in treasury bills rather than lending to the private sector.

This study used both primary sources and a "consumer survey" questionnaire obtaining the perceptions of customers (household and corporate), bankers and bank regulators. The results of the attitude survey have not yet been analyzed.

In conclusion, Mr. Gockel said that while FINSAP has had a positive impact on savings mobilization, further increases were being constrained by the failure of macro and fiscal policies.

Eric Nelson, Discussant

The study has "consumer survey" data which we hope will be used to incorporate perceptions about financial sector reforms and obstacles to reform in their model. Also, in the quantitative analysis, there should be more attention paid to problems of multicollinearity and unobserved variables. Since GDP is measured annually, the independent sample is smaller than it appears in the statistical tests and may not allow enough degrees of freedom for all of these variables to be included. The decision rules for deletions should be re-examined to distinguish statistical significance from economic significance. In these and other aspects, the functional form of the model should be improved.

The failure to get significant results from the financial deepening variable may be symptomatic of macro instability. This would help to explain both the lack of responsiveness of M2 to GDP and the high loan interest rates. The author places a big weight on capital adequacy and the risk weighting scheme as handed down by the Basle committee and feels that these have pushed banks toward instruments considered risk-free under the Bank for International Settlements standards such as treasury bills which lessens funds available for private borrowers. At the same time the rise of “magic banks” suggests this strict regulatory environment is in fact missing the underlying problem. Dollarization is likely to make monetary policy more difficult to implement.

Ghana's efforts to move to an electronic payments and clearing system seem ambitious.

Sam Ziorklui, *The development of capital markets in Sub Saharan Africa.* (research proposal).

At independence, Ghana had the same per capita income as South Korea. South Korea has enjoyed much higher rates of economic growth over the years since independence than Ghana. Ghana, along with much of Sub Saharan Africa (SSA), is now poorer on a per capita basis than it was at independence. Financial sector reforms are one part of the overall policy reform process that are important to SSA countries for improving their record of economic growth. Currently 11 stock exchanges exist or are in preparation in Sub Saharan Africa, but markets are thin and lack liquidity.

Ghana's financial sector policy reform did not, at the start, focus on developing capital markets. Reform in the commercial debt market dried up finance because of the introduction of higher reserve requirements. This and other institutional cost factors limited bank's lending capacity. Additionally, poor contract enforcement has raised lending costs through traditional banking channels.

The questions that Mr. Ziorklui seeks to answer in research undertaken in Ghana and Tanzania included:

- What has been the impact on capital market development of financial sector reform?
- To what extent has the existence of stock exchanges been a source of supply for long-term capital?
- What are the private sector's sources of long term finance?
- What are the prerequisites for establishing stock exchanges in SSA?
- What are the linkages between capital market development and real sector growth?
- How will capital markets in Ghana and Tanzania be regionalized or globalized?

The study has noted so far that the principal obstacle to privatization efforts to date in Tanzania and Ghana is the absence of buyers at any positive price for the institutions available.

Eric Nelson, Discussant

There are too many objectives, making the proposal unwieldy, expensive to implement, and without focus. It is not clear how efficiency gains are being measured here. For instance, how do you test macroeconomic stability and its effects in the study? Since emerging market funds find a stock market only marginally useful, how can we measure the existence of such a secondary market on the increase in equity capital which is the primary market? Beside a description of stock market development, how will the study analyze equity aspects of such development?

The data collection efforts are ambitious and there is a need to standardize data collection procedures so that others can replicate the study. Otherwise, Mr. Nelson strongly supports the study.

Questions and Comments from the Floor

Q. There is no stock exchange yet in Tanzania. Given Tanzania's state of development and the state of its formal financial sector in particular, won't it be difficult to assess the impact of macroeconomic stability on financial sector performance?

R. Mr. Ziorklui noted that the study will look at both listed and unlisted companies. The idea is that Tanzania can benefit from Ghana's experience in starting a stock exchange. Also, the banking sectors can be compared between these two countries. And, in regard to macroeconomic stability, Tanzania's performance in recent years has been better than Ghana's.

R. Mr. Gockel noted that the government of Tanzania is now promoting divestiture so that the state can off load ownership shares to private investors.

Q. In regard to the issue of financial repression and liberalization, could it be that the banks are not comfortable with the risk profile of private borrowers?

Responses

Mr. Gockel noted that Ghana has revised the Basle guidelines to derive an inappropriate capital adequacy profile. In regard to the relationship between financial sector performance and GDP growth, these two variables do not seem to be related during previous years.

Financial sector liberalization by itself does not mean that credit will automatically flow to all parts of the private sector. There is a range of other factors which the questionnaire is trying to capture.

Ghana is trying to improve other aspects of infrastructural development to facilitate private sector activities.

Mr. Ziorklui noted that bank's preference for lower risk investments than loans is easy to understand from a commercial viewpoint. The solution lies in better risk assessment, and this may imply development of credit information bureaus and the like.

In order to improve financial sector performance, macroeconomic imbalances must first be addressed. Uganda, for instance, has done a good job in macroeconomic and political management for stability.

In terms of financial deepening, is it driven more by saving mobilization or by the size of the government debt? If an economy experiences negative deposit interest rates, what type of response can you expect?

In terms of capital market development, collection of primary data is difficult, particularly in Ghana and Tanzania.

C. African Trade and Investment in Relation to the Global Economy

Chair: Fred Opio
Rapporteur: Abdoul Barry (AIRD)
Presenters: Margaret McMillan (IBI) and Marios Obwona (EPRC)
Discussants: Germina Ssemogerere (University of Makerere)
Presenters: Lynn Salinger (AIRD)
Discussant: Daniel Ndlela (Zimconsult)

Margaret McMillan and Marios Obwona, *Foreign and local investment in Africa*.

Mr. Obwona introduced the larger study objectives that would be addressed in two parts in this session. These included:

- Does Foreign Direct Investment (FDI) act as a catalyst for local investment? Is it vice-versa, or do both respond to similar investment climates?
- Are FDI and domestic investment (DI) complement or substitutes? In which sectors? How do different elements of the local business community feel about foreign investors?
- What is the role of local investors often considered resident aliens-namely Asians and Greeks in East Africa, Chinese and Indian in Mauritius? What role do ex-colonials play?
- How have DI and FDI interact on a global scale?
- Can we determine specific links between FDI and DI using country case studies for Kenya, Mauritius and Uganda?

Why Do We Care?

- Tendency to view FDI as panacea for low levels of DI in Sub Saharan Africa (SSA).
- Many countries in SSA expend considerable resources trying to attract FDI and providing special incentives to foreign investors.
- What if DI is the key to attracting FDI?
- Rodrick (1995) argues that exports in East Asia may have been a consequence of the increased profitability of DI.
- FDI ultimately is a very small percentage of overall capital formation in most countries.

Mr. Obwona presented the following data (Table 1) as a basis for determining how important is FDI as a source of capital? (Both columns reported as a percent of GDP)

Table 1: Sources of Investment by Region (Percent of GDP)

	Foreign Direct Investment		Domestic Investment	
	Mean	Standard Deviation	Mean	Standard Deviation
SSA	0.011	0.039	0.196	0.145
Asia	0.020	0.032	0.238	0.080
L. America	0.013	0.017	0.162	0.061
OECD	0.014	0.043	0.191	0.043
All	0.013	0.028	0.193	0.100

Source: IMF, International Financial Statistics Tape, 1997, UNCTAD, World Investment Directory V, 1996

Margaret McMillan, *Statistical analysis of foreign and local investment*.

Ms. McMillan used world-wide data to undertake a systematic, worldwide, econometric analysis of the causal relationship between FDI and domestic investment. Following a broad-ranging literature review focusing on the theoretical expectations for causality, Ms. McMillan provided a set of expected relationships in a tabular format (Table 2). These expectations and some empirical tests of them are further described in her paper

From this table, it can be seen that because of the large number of possible starting conditions, there are a large number of expected outcomes. Furthermore, most of the work undertaken to date examines the impact of FDI on domestic investment, not vice versa. Also, research in this area has not traditionally looked at Africa countries. In the global analysis for this study, no presumptions will be made about causality and it will be examined from both directions.

Table 2: Inward Foreign Direct Investment and Domestic Capital Formation

Effect/link	How it works	Net Impact on Domestic Investment
Labor market	FDI increases demand for labor & wages	Negative
	FDI trains workers making them more productive	Positive
	FDI brings managers that improve productivity	Positive
	FDI uses capital-intensive technology, thus reducing demand for labor	Pos/neg
Capital market	FDI drives up demand for domestic capital & its price	Negative
	FDI supplies additional capital goods & lowers price	Positive
Intermediate inputs	FDI purchase input locally	Positive
	FDI purchase input abroad	0/negative
	FDI supplies input locally	Positive
Technology	FDI technology easily mimicked	Positive
	FDI technology not easily mimicked	0/positive
Externalities "Spillover"	FDI increases the stock of human capital	Positive
	FDI investments in country-specific research development	Positive
	FDI provides access to overseas markets	Positive
	FDI invests in infrastructure	Positive
Government Revenue	FDI provides additional tax revenue for investment	Positive
	FDI provides additional tax revenue for consumption	0/negative
	FDI avoids taxation because of special deals	0/negative
	FDI is "tariff-jumping"	Pos/neg
Politics	FDI bribes official increasing political instability	Negative
	FDI suppress labor movements (SR vs. LR)	Pos/neg
	FDI promotes outdated institutions	Pos/neg
Income distribution	FDI uses capital-intensive technology	Negative
	FDI uses labor-intensive technology	Pos/neg
Balance of payments (BOP)	FDI worsen BOP situation making it more difficult for domestic investors to obtain imported inputs (royalty fees, transfer pricing, heavy use of imported inputs)	Negative
	FDI improves BOP making it easier for domestic investors to obtain imported inputs (finances pre-existing investment or ISI reduces imports)	Positive
	FDI for exports increases export earnings and provides foreign exchange for imported inputs	Positive
International Competitiveness	FDI produces import substitutes in which country does not have a comparative advantage, eventually reducing growth and investment by taking resources away from sectors in which it does have a comparative advantage	Negative
	FDI produces for export and acts as catalyst for growth in a sector where country does not have a comparative advantage	Negative

Using worldwide data, Ms. McMillan found that both domestic and foreign direct investment have a strong positive impact on future domestic investment. Domestic investment does not appear to be a good indicator of future FDI. Results were presented of Ms. McMillan's quantitative results which supported her summary of findings. In interpreting these results for SSA, she proposed that:

- Possibly, FDI has crowded out domestic investment in SSA in the past.
- Most FDI in SSA has been concentrated in capital-intensive, isolated mining and oil operations.
- Domestic investment has been a catalyst for FDI in SSA and Asia

- Domestic investment needs relatively few distortions to survive.

Marios Obwona, *Comparative results of case studies undertaken in Uganda and Mauritius.*

Mauritius provides one of the more positive cases of adjustment in Africa. From independence until the early 1980s, government employed an import substitution industrialization policy aimed at weaning the economy off of its dependence on sugar production. While many manufacturing industries were initiated during this period, the policy did not generate significant growth and may have even been a drag on economic development. Following a period of macroeconomic shocks in the early 1980s, Mauritius changed to a mixed industrialization strategy which promoted export-oriented manufacturing enterprises along with import substituting ones. Export processing zones (EPZ) were established during this period and these enjoyed phenomenal growth in their early years.

This export focused approach seems to have generated much greater growth for Mauritius than the import-substitution policy. Export earnings have increased by a factor of almost 100, local investment has grown as have savings rates, manufactures' share of GDP has grown from 6.5 percent to 30 percent, GDP itself has grown at an average of 14 percent during the years of this policy, and per capita incomes have increased accordingly. During this same period, the import substituting industries have been contracting. Beginning in 1995, government broadened its industrialization incentive scheme to include manufacture for local consumption. Tourism has become an increasingly important growth sector as has, more recently, the financial services sector.

Even though Mauritius is small (its population is only 1.1 million), its geographic isolation makes transport cost high, it has few natural resources, its economy was based on monocrop agricultural production, and it suffered at the start from high unemployment, still it has succeeded in joining the ranks of middle-income countries. How has this been achieved?

Pull factors for both foreign and local investors include:
- Political stability and policy consistency
- Cheap and trainable labor-literacy rate over 90 percent
- Macroeconomic stability
- Infrastructure well developed
- Preferential access to European (Lome convention) and U.S. markets
- People have strong ties with Hong Kong, Taiwan and India
- Export Processing Zone (EPZ) and government incentives.
- Preferential bank rates and sound banks
- An investor-friendly government since 1982

External "push" factors include:
- 1985 Sino-British agreement over Hong Kong
- Multifiber agreement and quotas imposed by the United States on Hong Kong
- Rising labor costs in Hong Kong and Taiwan

Linkages between local and foreign firms are considered important for the success of FDI in Mauritius. Local investors had equal access to the EPZs and invested heavily there. Additionally, foreign firms subcontracted with small local firms creating additional growth benefits. The labor market was flexible and well trained, and firms were allowed to bring in foreign workers who served as mentors for local workers. In addition, Mauritius' beaches have attracted tourists which has opened new opportunities for local producers (tourists look for bargains in EPZ shops and flowers are sold directly to tourists).

Conclusion on Mauritius: Economic success has been based on good policies and institutions (banks in particular) and has happened even though Mauritius has limited natural resources and began with few other economic advantages.

Mr. Obwona then provided a review of FDI experience in Uganda starting from Independence. Immediately following independence, the Ugandan government and British-Asian investors boosted industrial growth. But later, and despite the legal protection under Ugandan law, Obote's government nationalized foreign firms. The impact of this was to limit growth in domestic private investment. Domestic investment at that point became limited to public resources and monopolistic enterprises.

During the Amin era there was another spate of nationalization of industries and businesses belonging to foreigners. A rule was promulgated that foreign investors must be naturalized in order to do business in Uganda. In a later turn-around, the 1977 foreign investment decree exempted a foreign investor from import and sales taxes on plant and machinery. However, investors did not respond to this shift due to uncertainties about the policy environment and due to widespread recognition that the exchange rate was hopelessly overvalued.

The overthrow of Amin and the advent of an elected government did not by itself bring foreign investment. Not until a bill was passed by the parliament returning expropriated assets to their original owners did capital start returning to Uganda. In order to improve foreign investment in Uganda, the government embarked on an ambitious program to free the exchange rate, reduce trade and investment barriers, and to rationalize the legal system. In addition, significant resources have been allocated to the creation and operation of an institution (the Uganda Investment Authority) which facilitates trade and investment. These reforms have resulted in increased investment in Uganda. Between 1993 and 1995, private sector investment increased from 5.6 percent to 9.1 percent of GDP.

FDI is becoming increasing recognized in Uganda as beneficial to domestic firms. However, the consensus among informants is that the investment boom has not yet started for Uganda. It is widely thought that there are remaining constraints including reliability of power supply, reduction of communications costs, and reductions in transport costs. Furthermore, firms currently seem to be shifting away from import substituting industries and toward tradable goods.

The policy implications that can be drawn from these two case studies include:

- With time, good policies are rewarded
- These require macroeconomic, political and social stability and sound institutions
- The value of "enclave" populations to policy success

- The importance of a level playing field for foreign and domestic investors
- The importance of infrastructural and human capital development

Germina Ssemogerere, Discussant

In Mauritius, the emphasis on FDI has targeted exports and the government has invested heavily in this campaign. What has been the return to the campaigns? In Uganda, what has been the return to the new investment code?

Mauritius shows that market failures must be addressed. It shows that human capital development is an important ingredient to success; so is the nature of civil servants. Should the public sector should go out of its way to look for private sector investment? Investors look at industries which are profitable. As a result, one needs to know the comparative advantage of the country and also wage rate policies.

Predictability (in macro economic policies and politics) has not been taken seriously by Uganda, but this is also an important ingredient for policy success. FDI is not an engine of growth, just as trade is not.

Questions and comments from the floor

C. Dan Ndlela pointed out that productivity was not mentioned in the paper. The paper should also address the legal environment and the financial institutions. Mauritius is the case of transformation from a primitive economy to an industrial one (primitive capital accumulation).

C. Andy Sisson proposed that the paper look at different kinds of FDI.

Q. Ngure Mwaniki asked whether the EPZ had made a significant difference in Mauritius.

C. Fred Opio maintained that linkage between investment and growth is not clear in the case of Uganda.

B. Lynn Salinger, Abdoul W. Barry, Selina Pandolfi, *Pursuing the Africa Growth and Opportunity Act: Countering the threat of textile and apparel transshipment through Africa*.

The function of the Africa Growth and Opportunity Act (HR 1432) is to authorize a new trade and investment policy for Sub Saharan Africa (SSA). Its objectives include:

- Strengthening the private sector in SSA
- Encouraging increased trade and investment between the United States and SSA
- Reducing tariff and non-tariff barriers and other trade obstacles
- Expanding U.S. assistance to SSA's regional integration efforts
- Negotiating free trade areas

The act seeks to eliminate trade barriers and encourage an expansion of trade between Africa and the rest of the world. For Africa, this will entail economic liberalization and legal/regulatory reform. In the United States it will involve reducing obstacles to trade and an expansion of clothing and textile imports from Africa (eliminating existing quotas in Kenya and Mauritius) and eliminating duties under the Generalized System of Preferences. Further needs on the African side include a functioning and efficient customs system against illegal transshipment.

The benefits of preferential regional trade agreements were discussed as regards: NAFTA (Mexico, Canada and the United States); Caribbean Basin Initiatives; and Outward processing traffic (France-North Africa; Germany-Eastern Europe).

In regard to U.S. textile and apparel imports, Africa is not a major supplier to date. However, Asia is significantly affected under the act, and there is concern that Asian producers may try to transship production to U.S. markets through Africa due to weak customs regulations and enforcement there. Opposition to AGOA in the United States is not uniform.

Mechanisms to counter transshipment were discussed. These included: certification of country-of-origin by U.S. customs agents overseas and in-country investigations by U.S. customs agents overseas. These mechanisms may be thwarted by countries who either see investigations as political interference or who believe that the revenues gained through transshipment are not all bad.

An alternative strategy would be to invest donor resources in improving customs regime management within African countries. A second, private sector approach would be to use private, third party preshipment inspection firms to verify country of origin. This latter alternative is particularly attractive because several African countries already have contracts with PSI firms, and because it would be a simple matter to have the exporters or export associations pay associated fees (1 percent vs. 17 percent duty on imports).

Countering the threat of textile and apparel transshipment through Africa: Conclusions.

- AGOA offers tangible benefits to SSA trade and investment.
- Textile/clothing provisions offer SSA a chance to mimic success of NAFTA, CBI countries.
- Actual textile/clothing impact in the short-run would be small because of lack of capacity.
- Opposition could be overcome via transparent, internationally recognized visa system.

Daniel Ndlela, Discussant

The AGOA is a positive signal for Africa. But what difference would AGOA make for Africa in light of the small knowledge that African businesses have about this big market. It appears that very few countries will benefit from this initiative. Mauritius, Kenya and Lesotho will make up 80 percent of the U.S. market share. In addition, Africa may not be in a good position to take advantage of the AGOA given the low capacity. There has to be a learning process which will take place in the long run. Transshipment should not be a problem because even South Africa uses the same types of arguments against its neighbors.

Lynn Salinger. We are not interested in all of Africa, but a few countries which are endowed with a capacity. The products are not limited to clothes and cover apparel as well (pillow cases). Only Mauritius, Kenya and South Africa may be able to take advantage of the AGOA because of their capacity. We need to remember the study undertaken by the World Bank and entitled *Africa Can Compete.*

Margaret McMillan. Can Asians invest in Africa and not be affected by the transshipment problem?

Lucie Phillips. Productivity appears to be very important and Asians have helped to increase in Mauritius.

IX. Parallel Sessions, 11:00 Friday Morning, February 6

A. Electricity Trade in the Southern Africa Power Pool

Chair: Daniel Ndlela (Zimconsult)
Rapporteur: Dominique Njinkou (AERC)
Presenters: William Masters (Purdue University), Ferdi Kruger (ESKOM)
Discussant: Dirck Stryker (AIRD)

William Masters and Ferdi Kruger, *Modeling electricity trade in Southern Africa*.

This project is an effort to model electricity production and distribution by the Southern African Power Pool (SAPP). SAPP is a consortium of twelve countries in the region of which seven operate utilities companies. The organization was formed in 1995 with the objective of improving regional trade in electricity. The initial system was based on fixed, long-term contracts with prices determined by individual countries. The new system is driven by market-based mechanisms that can lead to reduced cost and greater availability and reliability of electricity supply. Under this system, the price and quantity produced would be regionally determined. Achieving this objective will require regional cooperation in three areas, namely: technical operation, new agreements, and new transmission lines.

The operation of the power pool is based on frequent meetings among members. Technical operations cover communication and harmonization in production and pricing practices. The model for determining price and quantity has been completed and results are available and cover three key points: regional trade (import and export) by each member of the pool under two different scenarios (with and without harmonization); value of traded volumes with and without harmonization; and daily cost.

The simulations show that there are significant gains from short term trading, even with current infrastructure. They show:

- large export gains for Mozambique, the Democratic Republic of Congo, and Zambia;
- cost savings for South Africa, Botswana, Namibia, and Swaziland; and
- there will be reduced CO_2 emissions.

Given the usefulness of this type of modelling for regional efficiency gains, the authors proposed additional modeling efforts of long term changes in the system. Such changes include:

- changing water levels and hydro-electric costs;
- gains from new transmission lines; and
- gains from new generating capacity.

Discussion

Market structure. National utilities companies have some monopoly power and we are not dealing here with a standard competitive market situation. Some countries, for example those in the northern part of the pool, may want to capture some monopoly rents. They may accept prices lower than the monopoly maximum, but they will most likely not go below a certain price which is above competitive market price. A supranational agency may be needed to coordinate and regulate the market. Some participants wondered whether SADC could fulfill this role.

Political economy issues. Electricity is one of the commodities often considered as strategic and countries may resist a high dependency on electricity supply. Power pooling/sharing at the regional level may diminish the threat but it is still there. In the same line, a participant wanted to know whether privatization was being considered. The authors said they were not sure but that the pressure was currently on distribution channels.

Poverty and welfare. Substitution of inefficient power generating by more efficient system leading to cheap electricity gives opportunities to promote small business and supply rural areas where most of the poor are located.

B. Financial Intermediation for the Poor

Chair: Haji Semboja, (ESRF)
Rapporteur: Margaret McMillan (IBI)
Presenters: Hamed Ndour (REMIX), Mohammed Karaan (University of Stellenbosch), Eric Nelson (DAI)
Discussant: Fred Opio (EPRC)

Eric Nelson, Hamed Ndour and Mohammed Karaan, *Financial intermediation for the poor in Senegal and South Africa.*

Mr. Hamed Ndour initiated the presentation by describing the field study undertaken in Senegal. That study looked at regulations governing financial intermediation and the behavior of poor households there. It was most noteworthy that even though 30 percent of all Senegalese households (and 58 percent of all rural households) live below the poverty line, there is a strong preference in this market for saving. Because, in large part, of Senegal's classically repressed financial system, over two million poor Senegalese are excluded from the formal banking system.

In 1980, some of the more bankrupt banks were liquidated. The state-owned bank was privatized. A new banking law was promulgated which provided for institutional security and greater protection for savers. This law gave some opening to innovative financial arrangements by allowing government exemptions to be granted to certain organizations. Specifically, the government can make agreements with NGOs that allow them to undertake a fuller range of financial intermediation.

The interest rate in Senegal is currently set at 12 percent. At this rate, much does not happen, including term transformation. Instead, much financial intermediation happens outside the formal system. Within the formal system, margins are highly constrained, therefore so is service provision.

The study looked at several different efforts to improve access to financial services for the poor. Noting the need for institutions that provide broader services more extensively and the importance of basing these institutions on savings mobilization, Mr. Ndour discussed briefly the village banking model. Under this model, funds were loaned by donors to a Senegalese funding authority. Those funds were then loaned to NGOs who in turn lent them to village banks. Village banks garnered deposits and made a healthy margin on their loans and were able to quickly repay their own debts to the NGO. The NGO was then able to reuse those loan funds to support new village banks. While this model is working well, Mr. Ndour proposed that the limitation on source of funds (e.g. donors, and NGOs) was artificial and constraining to the process. He felt that government should agree to allow traders and other private investors to invest in these institutions.

The government is also attempting to extend access to financial services by expanding the services provided by the postal bank. While there are 130 windows under this system, it is not clear to what extent financial service provision will be practical for postal employees.

In closing, Mr. Ndour recommended that Senegal further open its financial system to competitive pressures. This would entail making entry into the formal system easier and freeing up interest rates.

Mohammed Karaan discussed his study of the South African context for financial intermediation for the poor. One legacy of apartheid was a dualistic financial sector, one part of which was highly developed and served the white population and the other being much less developed. There was one DFI created during that period but it did not have a very extensive reach and was not successful at mobilizing resources. During that period, the poor were largely unserved except through informal intermediaries.

Several institutions have emerged to serve the poor with financial services and these institutions are assessed in case studies under this activity. These include donor-supported formal financial institutions such as the regional (homelands) agricultural banks, private sector operations, NGOs, and informal intermediaries. Their study examined a range of these arrangements as case studies. It was also noted that an extensive investigation had been made into the question of rural and small-scale finance by the Strauss Commission.

An important finding from these case studies is the importance of savings and deposit services to this clientele. In the past, most efforts to serve the poor and micro clientele have focused on expanding access to credit. The case studies for this activity looked at several agricultural banks in the homelands which attempted to provide small loans to clients there. They were found, by and large, to be unsuitable vehicles for sustained financial intermediation for the poor. Donors are now supporting a New Farmers Development Company which targets disadvantaged farmers who produce high value commodities. Under that scheme, clients make an initial contribution to the fund and are able to leverage this with borrowing.

An example of NGOs who are targeting the poor for financial services is the village banks. These institutions gather member shares and deposits and place these with commercial banks to collect interest. These funds are borrowed against and these loans are used to finance lending to members. A local association screens borrowers and makes loan decisions accordingly. This "savings first" strategy fits with current thinking about serving the poor and micro clientele. While it has been somewhat successful, outreach and growth is limited.

There are significant informal arrangements operating in South Africa by which the poor gain some access to financial intermediation. These arrangements include both savings and credit services and they seem to be expanding their outreach. Borrowing interest rates were in the range of 25 to 35 percent and these arrangements are marked by low borrower transactions costs. Lenders trade on information that they have on the borrower from other sources.

Eric Nelson summarized the study results from Senegal and South Africa. In his synthesis, Mr. Nelson noted the complementarity between his team's research results and the results generated by the Strauss commission's study results. In both studies, liquidity was found to be a central concern of the potential clientele with particular regard to income generation and diversification. Savings services were important, as were transfers. Access to credit was looked upon as a last resort by survey respondents. It was found that, by and large, formal sector institutions did not serve this clientele with savings and deposit services. In the case of Senegal, much of the failure of formal institutions in regard to this clientele could be attributed to bad policy. Given government imposed limitations on interest rates, the market does not clear for small scale financial intermediation.

The two studies looked at postal banks in both countries to see what could be gleaned from experiences with these.

Mr. Nelson was supportive of the village banking model as assessed in the two countries, although this approach has not generated the level of outreach that had been expected. This model has, at least, the virtue of sustainability. They are modeled on Tontines, with which locals are familiar so they are not too hard to introduce. Still, these operations are subsidy dependent and suffer from high costs at the level of the NGO's involvement. They also have the obstacle of regulations in Senegal which require exceptions for village banks and which necessitates the involvement of the NGO.

Catholic Relief Services (CRS), the NGO of choice in this operation, had hoped for 20 village banks to be up and running in Senegal at this stage of their project cycle, but there are only ten. The scope for expansion would be vastly increased if private investors were allowed to participate in village banks, but that is not legal in Senegal, currently.

Fred Opio, Discussant

It was clear from the Senegal study that the poor do not enjoy access to credit. Mr. Opio identified institutional inflexibility as a key problem in this. He felt that further linkages between the formal and informal sectors would help to relieve this problem. In particular, he too was supportive of the village bank model and saw this as a way to provide significant financial services to the poor in Senegal. His question on this was how do the village banks keep a lid on costs in loan recovery?

Mr. Opio did not see the South African case studies as focussing on the poor to the extent that the Senegal study did. Given that the regional agricultural banks did not serve the poor, was there some recommendation for how they might be gotten to do so? He was also concerned about money transfer issues in South Africa with particular regard to foreign remittances. Mr. Opio was supportive of the savings-based approach but he wondered what the Tontines (or the village banks) did with their money once it was collected.

Mr. Opio thought that Mr. Nelson's synthesis was helpful and he agreed that the issue of remittances needed further study. In conclusion, he noted the difficulty possessed by repressed financial systems for the poor.

Questions and comments from the floor

Q. Clive Gray wondered whether the policy implications drawn from the Senegalese study were applicable to South Africa.

Q. Marios Obwana asked about recovery rates across the various models. In particular, he wondered whether higher recovery rates led to lower interest rates. He asked how the village banks assess risk.

Q. A questioner asked what were the most important aspects of sustainability in the village bank model. Is it better to centralize risk through some mechanism?

Q. Another participant questioned why the poor do not enjoy access to credit. Is it a result of international ownership of banks? Why is it illegal for private investors to open banks?

Q. Can the poor access credit without being made poorer? What is the presenters' credible poverty alleviation plan?

Q. How was the poverty line established for these studies? Was account taken of improved access to food in the rural areas? What is the national savings rate in Senegal? Do village banks have the opportunity to develop further?

Q. A concern was expressed about the methodology employed in these studies. Only seven NGOs were reviewed. Is there any way to know whether these were representative of the wider population of NGOs working in this area? What should be the structure of village banks and how feasible will it be to achieve widespread outreach through this mechanism?

Responses

Mr. Karaan feels that experience suggests that village banks will have a key role in expanding access to financial services among the poor in South Africa. Furthermore, he feels that the NGOs analyzed in these studies are representative of the more successful efforts to extend financial services among the poor.

Mr. Ndour responded to the question about finance and investment in Senegal by noting that there is no data on the links between them there. In regard to the legal and regulatory environment, he noted that banks in Senegal are very tightly controlled there. There margins are quite low.

In regard to the point about high recovery rates and high interest rates, the high recovery rates derive from local solidarity. In this, it can be seen that while village banks work at the local level, they might not be so successful at the city level. In regard to policies that protect both the borrowers and the lenders, it is possible to let the market regulate itself. Risk assessment, however, needs to be extended.

In response to why the poor do not enjoy better access, they are a high cost, high risk clientele. That is why innovations are necessary. Some banks do have ties to international capital, but mostly in the area of currency trading. Interest rates are high currently, but they are not as high as some informal markets.

Mr. Nelson reiterated his key point regarding this clientele's preference for savings and deposit services. The donors must recognize this point. In regard to risk costs and margins, this link is not as relevant as it might seem because under the village bank model, the savers are lending to themselves. Innovations such as South Africa's Stockvels (substitutes for the NGO in the village banking model) are illegal in Senegal. To be a bank in Senegal one needs one billion in CFA.

In conclusion, it was pointed out that whether a bank is lending to members or to clients, it is necessary to have an interest rate that clears the market. Otherwise there will be welfare losses. One important issue that needs to be studied in this regard is how to reduce costs. Given that risk costs are a large share of banks' overall costs, how does one reduce risk?

List of Documents Presented at the Workshop

Andrianomanana, Pépé, Henri Ranaivosolofo, Louis Rajaonera, Claude Rakotoarisoa.
Amelioration de la transparence dans l' administration fiscale: pays d'étude': Madagascar.

Improving transparency in tax administration: Case study - Madagascar. (draft report)

Andrianomanana Pépé, Henri Ranaivosolofo, Suzanne Rabetokontany, Lois P. Ranariamarolaza, Jean Razafindravonona.
La politique fiscale en afrique subsaharienne: un nouvel examen du role des droits daccises.

Anim, Francis, Edwin Chookole Bbenkele, Donald C. Mead and Owen Skae.
The contribution of business linkages to the growth of productive employment among SSMEs in South Africa: Approaches and principal findings to date.

Barry, Abdoul W., B. Lynn Salinger and Selina Pandolfi.
Sahelian West Africa: Impact of structural adjustment programs on agricultural competitiveness and regional trade.

Barry, Abdoul and Ndaya Beltchika.
Trends in African trade. (survey paper)

BHM International.
Editorial guidelines for EAGER research documents.

Davies, Rob.
Global trade analysis for Southern Africa. The resource allocative effects of free trade areas in Southern Africa.

Engel, Karen.
Lessons from East Asia for promoting trade in Africa. (survey paper)

Gray, Clive.
United States practice in estimating and publicizing tax evasion. (discussion paper)

Goldsmith, Arthur A..
Restarting and sustaining growth and development in Africa: An overview of the institutional dimension.

Hertel, Thomas W., William A. Masters and Aziz Elbehri.
The Uruguay Round and Africa: A global general equilibrium analysis.

Isimbabi Michael J.
The WTO agreement and financial services in African countries: A review of policy and research issues.

Intermediation financiere et pauvrete au Senegal. (document ½)

Kahkonen, Satu and Patrick Meagher.
Contracting in Tanzania. (draft report)

M.A. Consulting Group, Nairobi.
Study on restarting and sustaining growth and development in Africa. Kenya country study. (draft scope of work)

McMillan, Margaret.
Statistical analysis of foreign and local investment. (draft report)

Mead, Don.
The Contribution of Business Linkages to the Growth of Productive Employment among SMMES in South Africa: Approaches and Principal Findings to Date.

Metzel, Jeffrey and Lucie C. Phillips.
Bringing down barriers to trade: The experience of trade policy reform

Musinguzi, Polycarp.
Monetary and exchange rate policy in Uganda. (interim report)

Mwanawina, Inyambo.
Global trade analysis for Southern Africa: The impact of capital flows into South Africa. (draft report)

Ndour, Hamet and Aziz Wane.
Financial intermediation and poverty in Senegal. (draft report)

Opio, Fred and Marios Obwona.
Comparative advantage and intra-regional trade for Uganda's non traditional export commodities: The case of Uganda, Kenya, Tanzania and Rwanda. (research proposal)

Obwona Marios.
Foreign and local investment in Africa: Case study of Uganda.

Obwona Marios, Lucie Phillips, and A. B. Ayako.
Foreign and local investment: Case study of Mauritius.

Phillips, Lucie.

Gemstone and gold marketing for small scale mining in Tanzania. (final report for phase 1)

The political economy of trade policy reform: Exploring an African paradigm.

Ramaivosolofo, Henri, Suzanne Rabetoktany, Louis Paul Randriamarolaza and Jean Razafindravonona.

Fiscal policy in Sub Saharan Africa: A fresh outlook on the role of excise tax. (preliminary report)

Radelet, Steven.

Regional integration and cooperation in Sub Saharan Africa: Are formal trade agreements the right strategy?

Relance de la croissance et developpement durable en Afrique.

Restarting and sustaining growth and development in Africa: Country study - Senegal. (scope of work)

Salinger, B. Lynn, Abdoul W. Barry and Selina Pandolfi.

Pursuing the Africa Growth and Opportunity Act: Countering the threat of textile and apparel transshipment through Africa.

Salinger, B. Lynn, Haroon Bhorat, Diane P. Flaherty and Malcolm Keswell.

Promoting the competitiveness of textiles and clothing manufacture in South Africa. (preliminary report)

Salinger, Lynn, Anatoli Amvouna, Deirdre, Murphy Savarese.

New trade opportunities for Africa.

Sparrow, F.T., W.A. Masters, Zuwei Yu and B.H. Bowen.

Modeling electricity trade in Southern Africa. (draft report)

Ssemogerere, Dr. G.

Competitiveness of Uganda's manufacturing sector: The current state and prospects. (draft report)

Stryker, J. Dirck , Fuad Cassim, Haroon Bhorat and Bala Rajaratnam.

Increasing employment and labour productivity in South Africa. (progress report)

Stryker J. Dirck.

Trade and development in Africa.

Vink, Nick, Mohammad Karaan and Catherine Cross.

Financial intermediation for the poor: A South African case study.

Wangwe, Samuel Mwita, Semboja Hatibu Haji and Ayubu Nyanga.
Study on business contracting practices in Tanzania. (draft report)

Ziorklui, Dr. Sam Q.
The development of capital markets and growth in Sub Saharan Africa. (research proposal)

Ziorklui, Sam Q. and Fritz Gockel.
The impact of financial sector reform on bank efficiency and financial deepening for savings mobilization in Ghana. (draft report)

Participant List

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